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P.O. BOX 112
MAPLEWOOD, NJ 07040

RICHARD P. RYDER, PRESIDENT

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October 23, 2003

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

RE: File No. SR-NASD-2003-95 - Amendments to Rules 10308 and 10312 of the NASD *Code* of Arbitration Procedure Governing Arbitrator Classification

Dear Secretary Katz:

While I understand that the prescribed comment period on this proposed rule has passed, I have been stimulated to write by the NASD's recent Response to Comments, dated September 30, 2003. That response declined to *make* any changes to, or to reconsider any aspect of, the proposed rule despite comments that raised serious and legitimate concerns. I hope that, as the Commission is digesting the NASD Response to Comments, it will also see fit to review the remarks below (and in the attached article). I appreciate the opportunity the Commission affords the public to comment during the rulemaking process.

I write as an arbitrator, a mediator, an arbitration attorney, and as a newsletter publisher, with more than two decades of experience with commodities and securities arbitration. The *Securities Arbitration Commentator* (SAC), a newsletter that tracks events and developments in this arena, is in its fifteenth year. I have been its editor and publisher since 1988. SAC strives to be party-neutral and pro-arbitration in its approach+

Not long ago, the Securities Industry Conference on Arbitration, which is billed as a confabulation of public, industry and SRO representatives whose purpose for three-plus decades has been to propose uniform arbitration rules for adoption by SRO arbitration forums, approved a change to the arbitrator classification provisions that differs from the NASD proposal. SICA prescribed the original formulas fur distinguishing between public and industry arbitrators in 1989 and has made revisions through the years.

In the latest change, SICA recommended that the classification criteria for public arbitrators be amended to exclude any professional whose firm derives more than 20% of its revenue from industry sources. That provision, which passed by a narrow margin, made two significant changes to the current regime: (1) it tagged the *20%* limitation to the professional's firm, instead of his/her personal efforts; and *(2)* it changed the standard of measurement to dollars (revenue), as opposed *to* time or "work efforts."

TEL: 973.761.5880 FAX: 973.761.1504 E-MAIL: help@sacarbitration.com
www.sacarbitration.com

These two significant alterations in the standards an arbitrator must apply to herself/himself in order to determine one's eligibility to serve as a public arbitrator have not been tested, No SRO arbitration forum has adopted the changes at this early juncture. The alterations are broad-reaching and will have unmeasured consequences to the size of the public arbitrator pool and to the sophistication and experience of those who will remain eligible to serve. SICA's rule proposal raises questions enough, but the NASD proposal extends the proposition from questionable in nature to inadvisable.

The SICA proposal only tries to *make* two major changes instead of three. The NASD proposal makes the same two changes as the SICA proposal does, i.e., person-to-firm and work efforts-to-dollars, and it also halves the elimination percentage from 20% to 10%. Why is it necessary for NASD to distinguish its proposal from SICA's proposal and thereby to ensure rule confusion instead of rule uniformity with the other SRO forums? Why should three changes of significant, but uncertain, consequence be permitted by the Commission when making two such changes presents great potential risk?

I am attaching the draft of an article written for SAC by Professor Katsoris, currently the Chair of SICA and a founding Public Member of that group. His article makes many fine points that recommend care and deliberation in this area. Changing the formulas by which arbitrators are classified or by which Panels are composed is heady and delicate work. No doubt some who favor the current proposal do so in the belief that it can only favor the investor, so why should it be: opposed? That simplistic approach presumes all unintended consequences will also favor the investor, a premise that is definitely not the case.

Others may believe that changing "who" will decide cases will alter the fairness quotient, i.e., that claimants will win a greater percentage of the cases tried and/or recover a larger percentage of their requested damages. This is certainly a potential outcome, but if tinkering with outcomes is the purpose, it should be done without stealth and the method should assure the objective . If tilting the playing field is an intended consequence, then the Commission should examine and determine arbitration's deficiencies. To be appropriate, I respectfully submit, tilting the fairness quotient further in the claimant's favor needs to be justified. There is no evidence in past GAO reports, in the statistical reports that SAC publishes, or in the public record, suggesting that securities arbitration's fairness quotient is clearly out of kilter, either with the times or with outcomes in alternative forums.

What are some potential, presumably unintended consequences? Let us assume that the proposed changes will result in a less sophisticated, less experienced pool of arbitrators. If so, less sophisticated, less experienced arbitrators may be more susceptible to emotional appeals, to irrelevant but inflammatory evidence, to hyperbole and theatrics than today's public arbitrators. Since counsel are likely to follow the path that works, this change may encourage less civility and decorum in arbitration hearing rooms. Unsophisticated, inexperienced panelists must take more time to be educated about investment products, industry procedures and practices, and applicable regulations. As a result, they are more likely to be guided by counsel. than to lead. If a classification shift will diminish the skills that distinguish arbitrators from juries, then the unintended consequences of greater expense, heightened incivility, longer hearings and less predicable results are certainly collateral risks. These consequences are not good for arbitration and probably disfavor claimants more than respondents, especially investors with severely diminished resources.

Public confidence in a system that places decisions in the hands of arbitrators who have great power and inadequate skills will not grow; it will fade. Industry support for a process that is becoming increasingly hostile must at some point falter. One hesitates to sound the alarm too loudly, but Prof. Katsoris' call for further study merits the Commission's consideration and, at the least, the NASD's rigid insistence on three major changes to the critical classification formula, when SICA has haltingly recommended only two, warrants more explanation and less haste.

Thank you for your consideration of the foregoing.

Sincerely,

Richard P. Ryder

Encl.

Covering Significant Issues & Events in Securities/Commodities Arbitration *Vol. 2003, No. 6*

SECURITIES ARBITRATION
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IN THIS ISSUE

PUNITIVE-DAMAGE AWARDS: THE END OF EXCESS?

by Jack Malley, Esq.*

*(**SAC** Editor: **In** the most recent four issues of **SAC**, we have chosen, with the help of members of our Board of Editors and other guest authors, to present dual articles on the important topics of discovery in arbitration and the awarding of punitive damages. Prof. Jill Gross' article about the problems with pre-Panel discovery (Vol. 2003, **No.** 3) was met by a responsive article from NASD's Barbara Brady in Vol. 2003, No. 5. In between, we published a piece **by** Deborah Masucci in Vol. 2003, **No.** 4, who, as Director of Arbitration at **NASD** for 15 years, **knows** first-hand the place of the Supreme Court's* **State Farm** *decision in a debate about punitive damages that has raged for years in securities arbitrution circles. Complementing that unique historical commentary is the article below by defense attorney Jack Malley, who approaches the* **State** Farm *decision with the sharpened tools of legal and tactical analysis. Of course, discovery and punitive damages are not the only "hot" arbitration issues. **In** the last edition, Prof. Constantine N. Katsoris wrote a provocative article about the six-year eligibility rule (Vol. 2003, **No.** 5) and, in this edition (see inside, p. 3), he discusses SRO arbitrator classifications, raising our awareness to the potential pitfalls in the **NASD**'s new proposal on public arbitrators. **This** has been a good series and we **cap** it proudly in this edition with fine articles by Jack Malley and "Gus" Katsoris.)*

Introduction

The misconduct of Wall Street firms during the late 90's bubble has been one of the most prominent stories over the last year. **The** media coverage of the improper, and even fraudulent, practices that certain firms allegedly engaged in has contributed to the dramatic increase in the number of securities arbitration claims filed. In 2002, the **NASD** received 7,704 claims, the most in its history, and it is on **a** pace to receive approximately 10-12,000 claims in 2003, which would shatter the 2002 record. **In** addition, claims submitted to the NYSE nearly doubled in 2002 to 1,009 from 541 in 2001.

Given the spate **of** negative publicity, it would seem that Wall Street firms named in recently filed securities arbitrations are more vulnerable than ever to excessive punitive damage awards. However, **a** recent decision by the **U.S.** Supreme Court, *State **Farm** Mut. Auto. Ins. Co. v. **Campbell**,*[1] sets forth a clear framework for the identification of excessive punitive-damage awards. **As** a result, firms should now be *less vulnerable* to such awards if arbitrators are sufficiently informed of the *State **Farm*** holdings.

State Farm v. Campbell

In *State **Farm**,* Curtis Campbell ("Campbell") attempted to pass several vans traveling ahead **of** him on a two-lane highway causing a collision of the cars driven by Todd Ospital and Robert G. Slusher. Ospital died in the collision and Slusher was rendered permanently disabled.

In the ensuing wrongful death action, Campbell's insurance company, State Farm, contested

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* *Jack Malley, **Esq.** concentrates his practice in securities litigation at Herrick, Feinstein LLP. He can be reached at (212) 592-1574 or jmall@herrick.com.*

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liability and declined offers by Slusher and Ospital's estate to settle their claims for $25,000 each – the policy limit. At trial, the jury found that Campbell was 100% at fault and returned a judgment against him in the amount of $185,849. Initially, State Farm refused to cover the $135,849 in excess liability. However, when the Utah Supreme Court denied Campbell's appeal in 1989, State Farm paid the entire judgment.

Subsequently, Campbell and his wife, Inez, filed a complaint against State Farm alleging bad faith, fraud and intentional infliction of emotional distress. At trial, the Campbells contended that State Farm's failure to settle the wrongful death action was part of a national scheme to achieve corporate fiscal goals by capping claim payouts. State Farm contended that its decision to take the case to trial was an "honest mistake." The jury awarded the Campbells $2.6 million in compensatory damages and $145 million in punitive damages, which the trial court reduced to $1 million and $25 million, respectively. On appeal, the Utah Supreme Court reinstated the $145 million punitive damages award.

The U.S. Supreme Court granted certiorari and reversed the Utah Supreme Court by a decision dated April 7, 2003. In the decision, the Supreme Court first set forth the constitutional boundaries on punitive-damage awards by holding that the due process clause of the 14th Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor. The Court also reiterated its holding in *Honda Motor Co. v. Oberg*,[2] that "punitive damage awards pose an acute danger of arbitrary deprivation of property[,] ... and [that] the presentation of evidence of a defendant's net worth creates the potential that juries will use their verdicts to express biases against big businesses."

After laying this constitutional groundwork, the Court applied the three guideposts for reviewing punitive damages that it announced in its 1996 decision, *BMW of North America, Inc. v. Gore*:[3]

> (1) the degree of reprehensibility of the defendant's conduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

With respect to the first *Gore* guidepost, the degree of reprehensibility, the Supreme Court found that the Utah Supreme Court's analysis was wrong because it condemned State Farm for its nationwide policies rather than for the conduct directed toward the Campbells, and further, that the case

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EDITOR-IN-CHIEF
Richard P. Ryder

SENIOR EDITOR
Samantha B. Rabin

SECURITIES ARBITRATION COMMENTATOR - Editor and Publisher: Richard P. Ryder, P.O. Box 112, Maplewood, N.J. 07040. Business Office: 93 Riggs Place, South Orange, NJ 07079. Tel: (973) 761-5880. FAX No. (973) 761-1504.

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THE COMPOSITION OF SRO PANELS?'

*by Constantine N. Katsoris**

When the Uniform Code of Arbitration was originally adopted by the Securities Industry Conference on Arbitration **(SICA)** it provided €or the number of arbitrators and the manner in which they were selected.[2] It further *provided* that the Director of Arbitration of the **SRO** choose the panel and its chairperson and directed that the *majority* of the panel of arbitrators be *public arbitrators* (and *not* from the securities industry), unless the public customer or "non-member" requested otherwise.[3] In addition, the Code *provided* that each party would have one peremptory challenge,and unlimited challenges for cause.[4]

SICA later expanded the definition of who is a *securities industry arbitrator* by specifically including an attorney, accountant, or other professional who within the last two years has devoted 20 percent or more time to securities industry clients, such as broker/dealers or registered representative~.~

The most significant change regarding arbitrator selection, however, occurred a few years ago and involved the method for the appointment of arbitrators.[6] Where previously the SROs selected the arbitrators,[7] the Uniform Code now provides that the parties may jointly select the arbitrators; otherwise, they are provided with two randomly generated lists of arbitrators – one of *public arbitrators* and one of *security industry arbitrators* – from the SRO's panel (list selection method). Under the list selection method, if three arbitrators hear a case, a party may strike any **or** all **of** the names from the lists without providing an explanation and may number in *order of preference* the remaining names on the lists, if any.[8] Arbitrators are then invited to serve based upon the parties' mutual preference ranking.[9]

Earlier this year **SICA** amended Section 16 **of** its Uniform Code to restrict those who could be a *public arbitrator* by providing that an attorney, accountant or other professional *whose **firm*** derives *20* percent or more of its annual income from securities industry representation cannot be classified as a *public arbitrutor.* This amendment was adopted, but only after much debate[10]; for, regardless of whether one supports or opposes this rule, collateral issues will arise as to its interpretation and implementation.

In applying this percentage rule, differences of opinion will surely surface as to how to calculate income from securities industry representation. For example, is drawing a lease of office space for the parent, subsidiary or major shareholder of a brokerage firm considered industry representation? Similarly, what **is** the effect of representing a brokerage firm together with several other unrelated claimants or defendants in **a** non-securities matter? Are fees from representing a broker *against* his or her firm considered income from securities industry representation? Do the fees of mediators in securities disputes count, at least in part, as securities industry representation? Moreover, how do you handle the dilemma where, in the same year a *firm* receives 20% of its income from an industry client, it also derives 25% of its income from representing third parties against the industry?

Another problem is the shifting landscape of one's practice, as it cuts across calendar years. Suppose my firm's practice was 15% industry in 2003, **28%** in 2004 and 12% in 2005; and, **I** was appointed a public arbitrator on a long case late in 2003 that unavoidably spanned three calendar years. Does my status change in 2004 or 2005? In addition, what is the effect if an arbitrator miscalculates,and inadvertently sits on a case as a *public member,* then renders a decision and subsequently discovers he has violated the percentage guidelines. Can **there** be a challenge to the award?

There are also timing issues as to when and how much income is recognized. For example, in calculating income percentages do we use the cash method, the accrual method or some hybrid method? Moreover, are we interested in net or gross income; or instead, in gross receipts (billable time plus disbursements) or net receipts (without disbursements)?

Equally significant **is** at what percentage do we set the bar that triggers such disqualification? Truthfully, no matter what figure you choose, it is somewhat arbitrary and creates an atmosphere of numbers roulette. **As** noted earlier, **SICA** previously set the disqualification bar through firm membership at 20% of the firm's income.

cont'd on *page 4*

* Constantine N. Katsoris. Wilkinson Professor of Law, Fordham University School of Law; J.D. 1957, Fordham University School of Law; LL.M. 1963, New York University School of **Law;** Public Member of Security Industry Conference on Arbitration 1977 - present; Member **of** Board of **SAC** since 1997; Public Member of National Arbitration Committee of the NASD, 1974-81; Public Arbitrator at **NASD** (since 1968) **and NYSE** {since 1971); Arbitrator and Chairman Trainer at NASD and **NYSE** (since 1994); Mediator at NYSE and NASD (since 1997); Arbitrator at First Judicial Dept. (since 1972); Private Judge at Duke **Law** School's Private Adjudication Center (since 1989); Arbitrator at the American Arbitration **Association** ("AAA") (since 1991).

PANEL COMPOSITION cont'd *from* page *3*

More recently, however, the **NASD** has sought to halve that threshold to 10% per year over a two-year period.[11] Regardless of the merits of percentage disqualification, **I** respectfully suggest that a **10%** threshold is too low because it will create too large **a** dragnet.[12] **As** well intentioned as the rule may **be, I** suspect that the net effect will result in an administrative nightmare for the SROs and cull from the ranks of *public arbitrators*[13] many knowledgeable and outstanding candidates of impeccable credentials and integrity, at a time when SRO caseloads are exploding and the contents of the cases becoming more complicated and complex.

Not surprisingly, the securities industry has countered with the suggestion that if "partisan" representation (i.e., representing the industry) disqualifies one from being a public arbitrator it is only fair that similar claimants' representation should disqualify that professional from being an industry arbitrator. Regardless of how one feels on that issue, such reciprocal treatment – on its face – has a ring of fairness to it.

Finally, **as** is evident from the aforementioned discussion, the battle to define who is an industry arbitrator and who is a public arbitrator has been an ongoing struggle since the two classifications were first established **by SICA** over 25 years ago. Looming *on* the horizon, however, is **a** related and more fundamental issue, namely: suggestions that the industry arbitrator classification be eliminated altogether, leaving only public arbitrators on SRO panels. Understandably, such an action will be viewed by **the** industry as an attempt to "stack the deck" against it.

It should also be noted that the dual classification system established by **SICA** was long established when the issue of fairness of arbitration was raised before the Supreme Court in *Shearson/American* Express, *Inc.* v. *Mc Mahon.*[14] Not insignificantly, over one hundred thousand arbitrations have been filed under this dual classification system at the various **SROs** since the enactment of the **SICA** Code. During that time, I have participated as a public arbitrator in scores of such cases and, more recently, was also instrumental in the establishment of a securities resolution clinic at Fordham to assist investors who found it difficult to obtain representation.[15] Absent isolated complaints of conflicts or incompetence of arbitrators which surface from time to time regarding both classifications, **I** have personally found the overall competence and integrity of arbitrators to be excellent. Although constantly improving the pool of arbitrators is and always should be a priority, my feeling is that the present dual classification system, together with the list selection procedure, has brought **a** balance to the process.

Not that any system is perfect, or that change should not be explored; but, at the very least, before such a radical change as the elimination of the dual classification system is ***even*** contemplated, an in-depth, independent and objective study should be undertaken as to the overall fairness of SRO panels (since the SICA **Code** was established) including an overall comparison with other **ADR** providers.[16] In the final analysis, perhaps a more simplified system would result from such a study, where all classifications would be eliminated and replaced with a potpourri of list selection, in conjunction with a peremptory challenge or two, and unlimited challenges for cause. Would such a change be a panacea? It would depend upon the eye of the beholder.

ENDNOTES

[1]Second reprint rights reserved,

[2]Constantine N. Katsoris, ***The Resolution of Securities Disputes,*** *6* FORDHAM J. OF CORP. AND FIN. **LAW,** 307 at 328 (2001).

[3]*Id.*

[4]*Id.*

[5]*See* FOURTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION (Aug. 1989) at 2.

[6]*See* TENTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION (June 1998) at 4-5.

[7]*Id.*

[8]The requirement that a majority of the panel of arbitrators be ***public arbitrators*** has been retained under the list selection method, ***Id.***

[9]*Id.*

[10]The author is not at liberty to reveal the actual SICA vote without SICA's permission.

[11]SEC Release No. 34-48347; Fed. Reg. Vol58 No 162, (Aug. 21, 2003).

[12]Furthermore, it is difficult to reconcile the proposed rule that prohibits a professional who may do <u>no securities work whatsoever</u> from being a *public* ***arbitrutor*** (because his or her firm breaches a *10%* ***threshold)*** with a rule that recognizes a professional as an industry arbitrator (therefore not a ***public arbitrator)*** only if he or she personally devotes *20%* or more of their professional work to industry clients.

[13]Not only would some be purged directly by the provisions of the rule, but also indirectly by discouraging many experienced public-spirited applicants from even applying.

[14]482 **U.S.** 220 *(1987).*

[15] ***See*** Constantine N. Katsoris, Securities Arbitration: A Clinical Experiment, 25 Fordham Urban L.J. 193 (1998); Fordham law Students Win Punitives for Investor, **SEC.** ARB. COMMENTATOR, June 2003, at 12.

"[O]nce a case is accepted, the full panoply of ADR procedures should be available, as with private representation. . .[I]f mediation is practical, it should also be available to the clinic. Similarly, if an award has to be confirmed or vacated, the clinic should be able to do so." *Id.* ***See also*** Leonard Post, Help for 'churned and burned', The National Law J., February 10, 2003 at A6.

"The SEC, the National Association of Securities Dealers (NASD), the New **York** Stock Exchange (NYSE), and local bar associations refer prospective clients to the clinic. Besides having a compelling case, clients must also qualify under a school's financial criteria." ***Id.***

[16]It is worthy of note that SICA inaugurated a pilot program to provide an alternative forum for the resolution of securities disputes at non-SRO forums. ***See*** The Resolution of Securities Disputes, *supra* note 3 at 361. ***See also*** Michael **A.** Perino, Report to the Securities and Exchange Commission Regarding Arbitration Conflicts Disclosure Requirements in NASD and **NYSE** Securities Arbitration (Nov **4,** 2002), SEC website: www.sec.gov/divisions/marketing.

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was used as a platform to expose and punish the alleged deficiencies of State Farm's practices nationwide, The Court emphasized that the conduct of State Farm in other states with regard to its program should not have been considered in the ,reprehensibility analysis because much of the identified out of state conduct was lawful. The Court also found that even if any of State Farm's out of state conduct was unlawful, Utah did not have a legitimate interest in punishing State Farm for unlawful acts committed outside of its jurisdiction. Finally, although the Court held that repeated misconduct can be considered in the reprehensibility analysis if the conduct in question replicates the prior transgression, it found that the conduct of State Farm that was submitted by the Campbells was not relevant because **it** was not similar to the conduct that harmed them.

With regard to the second *Gore* guidepost, the Court declined to impose a bright line ratio which a punitive-damage award cannot exceed. However, it provided very clear guidelines as to what types of ratios are excessive. The Court said:

- Courts must ensure that any punitive-damage award is both *reasonable* and *proportionate* to the amount of harm to the plaintiff and to the general damages recovered.

- Few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.

- An award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety.

- Ratios greater than those the Court has previously upheld (referring to awards of double, triple and quadruple damages) may comport with due process where a particularly egregious act has resulted in only a small amount of economic damages.

- When compensatory damages are substantial, a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guaranty.

- The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award.

Applying these guidelines to the award against State Farm, the Court found that there was **a** presumption against a 145-to-1 punitive-damage award and that the $1 million compensatory award was substantial and complete compensation because: the harm arose from an economic transaction, not from a physical assault or trauma; the Campbells suffered **a** minor economic injury for a period of only 18 months because State Farm paid the excessive verdict before the Campbells filed their bad faith action; the Campbells were awarded $1 million for 18 months of emotional distress; and the punitive-damage award was most likely duplicative of the part of the Campbells' compensatory damages that related to their emotional distress because punitive damages are meant to condemn the type of outrage and humiliation that caused the Campbells' distress.

The Supreme Court also rejected the Utah Supreme Court's analysis of the third *Gore* guidepost by briefly noting that the most relevant civil sanction under Utah law for a wrong done to the Campbells appeared to be only a $10,000 fine for an act of fraud. In addition, the Court found that the Utah Supreme Court's speculation about State Farm's loss of its business license, disgorgernent of profits, and possible imprisonment were not persuasive because that speculation was based on evidence ***of*** dissimilar out of state conduct related to the "nationwide" scheme that the Campbells based their claim on.

Based on the Gore analysis, the Court said that the issue was "neither close nor difficult" and held that the Utah Supreme Court's reinstatement of the jury's $145 million punitive damages award was error. In addition, as part of its remand to the Utah Court, the Supreme Court took **the** unusual step of effectively dictating the amount of the "reasonable" punitive damages that the state court should award by finding that the *Gore* guideposts "would [likely] justify a punitive damages award at or near the amount **of** compensatory damages."

Motions to Vacate under State Farm

It is well established that, in addition to the explicit grounds for vacatur found in the Federal Arbitration Act, an arbitration award "may be vacated when an arbitrator has exhibited a 'manifest disregard of the law.'"[4] The Court's standard of review under the doctrine is "severely limited." To vacate the award, the Court must find "'something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law."' In ***Westerbeke*** *Corp. v. Daihatsu* ***Motor*** Co., *Ltd.*, **a** 2002 decision, the Second Circuit set forth the oft stated test to be applied for this limited review:

> The two-prong test for ascertaining whether an arbitrator has manifestly disregarded the law has both an objective and **a** subjective component. We first consider whether the "governing law alleged to have been ignored by the arbitrators [was] well defined and clearly applicable." **...** We then look to the **knowledge** actually possessed by the arbitrator. The arbitrator must "appreciate[] the existence **of** a clearly governing legal principle but decide[] to ignore or pay no attention to

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> it." ... Both of these prongs must be met before a court may find that there has been a manifest disregard of law.

A recent decision by one of New York's mid-level appeals courts, the Appellate Division, First Department, vacating an **NASD** panel's punitive damage award based on a *Gore* analysis obtained some notoriety in the trade press as evidence of the proposition that courts have recently been applying a less deferential standard to motions to vacate an arbitration award. In ***Sawtelle v. Waddell & Reed, Inc.***, Steven A. Sawtelle ("Sawtelle"), a mutual fund broker, was terminated by Waddell & Reed, Inc. ("Waddell") after 17 years of employment. One day after his termination, Sawtelle joined Hackett Associates, a Waddell competitor, thus igniting a competition between Sawtelle and Waddell for the 2,800 customers previously serviced by Sawtelle.

On that same day Waddell wrote letters to Sawtelle's customers informing them that he was no longer their representative, and explaining the potential tax liabilities if the customers transferred their accounts. When Sawtelle's customers called Waddell after receipt of Waddell's letter, Waddell's representatives refused to inform the customers of Sawtelle's whereabouts. Sawtelle mailed his own letter to the customers informing them of his new association.

In addition, on several occasions, Waddell representatives suggested to Sawtelle's customers that Sawtelle may have engaged in criminal activity. Also, the U-5 form submitted by Waddell indicated that Sawtelle had been discharged for personality differences, and stated that Sawtelle was under internal review for fraud and other improper conduct.

Sawtelle filed a statement of claim against Waddell and certain of its officers with the **NASD** alleging tortious interference with business expectancy and violation of the Connecticut Unfair Trade Practices Act ("CUTPA"). After more than 50 days of hearings, the panel issued an award finding all the respondents jointly and severally liable for \$1,827,499 in compensatory damages, plus attorneys' fees of \$747,000. In addition, the award provided that Waddell and its president, Robert **L.** Hechler, were jointly and severally liable under CUTPA for punitive damages in the sum of \$25 million for their reprehensible conduct in orchestrating **a** campaign of deception regarding Sawtelle's handling of his clients' investments giving the impression that he was dishonest.

Sawtelle commenced **a** proceeding in New York State Supreme Court to confirm the award. Respondents cross-petitioned to vacate or modify the award, arguing that the punitive damages award was irrational. The Court reduced the compensatory damages award by \$747,000 to \$1,080,499 to reflect its finding that the panel issued a double award of attorneys' fees, but upheld the punitive damages award. Waddell appealed to the First Department.

The First Department vacated the punitive damages award by applying the *Gore* guidelines. Initially, the Court rejected respondents' contention that *Gore* was not applicable to the award on the ground that it only applied to the due process limitations on punitive damage awards, a principle which is inapplicable to private arbitration. The Court held that *Gore* applies to the due process analysis of a punitive damage award *and* also provides **a** guide for analyzing whether a punitive award is irrational or excessive under review pursuant to the Federal Arbitration Act.

Applying the *Gore* guidelines, the Court found that the degree of reprehensibility was not sufficient to support the punitive damages award because Hackett's immediate hiring of Sawtelle, his retention of most of his clients, and his continued high level of income (\$800,000 a year), showed that Waddell's misconduct failed, and therefore, it was not sufficiently egregious to warrant a \$25 million award. In addition, the Court found that the proportionality of the punitive damages "ran afoul" of ***Gore*** because the award was well above the four-to-one ratio that the ***Gore*** Court found was "close to the line." Finally, the Court found that the punitive-damage award did not comply with *Gore* because it was well out of proportion to the civil or criminal penalties that could be imposed on the respondents based on the Court's review of **CUTPA** cases, which revealed that punitive damages in those cases ranged from \$250 to \$450,000.

Based on this analysis, the First Department vacated the punitive-damage award under the manifest disregard of the law test on the ground that the panel had completely ignored the applicable law — even though the parties did not specifically refer to the ***Gore*** case at all during the arbitration.[5]

Sawtelle demonstrates that even prior to the *State Farm* decision, a panel that was informed of the ***Gore*** guideposts, and still issued a plainly excessive award, was vulnerable to **a** motion to vacate for manifest disregard of the law. While the *State Farm* decision will not change the general rule that motions to vacate arbitration awards are not easily granted, it should increase the potential for vacaturs of excessive punitive damage awards. Clearly, it sets more rigid limits on the permissible ratio of punitive to compensatory damages.

The Impact of the Compensatory Damages

While the *State Farm* decision established that awards exceeding a single-digit ratio are suspect, the Supreme Court left an opening, as it did in *Gore*, for the sustaining of these types of awards where "a particularly egregious act has resulted in only a

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small amount of economic damages." Thus, where the compensatory award is small, courts applying the "severely limited" manifest disregard of the law test to a double digit punitive damage award, should only vacate the award if it can find that there was absolutely no colorable justification for the panel's decision that the respondent's act(s) were "particularly egregious." Decisions published after *Gore* show that courts are hesitant to do this.

For example, in ***Acciarda v. Millennium Securities Corp.***,[6] Judge Betts of the Southern District of New York denied a motion to vacate a $100,000 punitive damages award that was based on a $5,000 compensatory damages award for defamation, a 20 to 1 ratio. In denying the motion to vacate, Judge Betts emphasized the Supreme Court's holding in *Gore* that there is not a rigid rule to be applied to the ratio issue, especially where the compensatory award **is** small, as it was in that case.

In ***Sanders*** v. *Gardner*,[7] Judge Seybert, also of the Southern District of New York, applied the ***Gore*** guideposts and denied a motion to vacate a $10 million punitive damage award ($2 million against three respondents and $4 million against another), where the compensatory damages were approximately $184,000, a ratio of more than 50 to 1. Judge Seybert justified the high ratio by emphasizing the egregiousness of the respondents' conduct, including their violation of an **SEC** consent decree.

However, under ***State Farm,*** a high ratio cannot be justified by a "particularly egregious act" where the compensatory damages are substantial, and the Supreme Court made it clear that, at least in some cases, a **1** to **1** ratio is appropriate in that circumstance. Therefore, courts that review future punitive damage awards that exceed **a** substantial compensatory award **may** be more inclined to vacate the award.

Whether or not ***State Farm*** will lead to more frequent vacaturs, the broad statements ***of*** the ***State Farm*** court that "few awards exceeding a single-digit ratio ... will satisfy due process," and that "award[s] of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety," should operate to deter some panels from issuing excessive punitive damage awards as a response to the recent Wall Street scandals – if they are informed of these holdings by the respondent.

Preventing Excessive Awards

Where claimants seek punitive damages well in excess of the alleged compensatory damages, respondents should submit the ***State Farm*** holdings to the panel. Making a clear record of that submission will reduce the potential for the issuance of an excessive award and preserve objections to any such award for a motion to vacate. Respondents should begin this effort by citing to the applicable parts of the ***State Farm*** decision in their initial appearance in the arbitration.

For example, if the claimant seeks a substantial amount of compensatory damages, and punitive damages that exceed that amount, the respondent should assert an affirmative defense stating that such a punitive damage award would be excessive under ***State Farm.*** Respondents should also submit the *State Farm* holdings in any pre-hearing or post-hearing briefs, and orally during the hearing. In addition, large firm respondents would be wise to emphasize the Supreme Court's admonition that the wealth of a defendant cannot justify an otherwise excessive punitive damages award at the appropriate times during the arbitration. Finally, respondents should be prepared to submit ***State Farm*** where a claimant attempts to admit evidence of alleged misconduct that is not similar to the conduct that allegedly harmed the claimant. For example, in **a** suitability arbitration, respondent should object to evidence that it had allegedly been engaged in "spinning" and "laddering" activities.

By making this type **of** clear record, if an excessive award is issued, there will be no question that the respondent preserved its grounds for a motion to vacate based on the manifest disregard of the law, because the panel would clearly have "appreciated the existence of [the] clearly governing legal principle" when it issued the award.

Conclusion

The publicity generated **by** the recent Wall Street scandals has created an atmosphere in which some arbitrators may be more inclined to issue Unreasonably large punitive damage awards. However, any such inclination should be tempered if arbitrators are sufficiently informed of the ***State Farm*** decision. Therefore, where punitive damages are alleged, respondents should submit *State **Farm*** at all the appropriate times during the arbitration. Although the ***State Farm*** decision will not alter the conventional wisdom that motions to vacate are infrequently granted, excessive punitive damage awards that are issued by panels that are informed of the decision will now be more vulnerable to vacatur because of the clarity of the Supreme Court's holdings.

ENDNOTES

[1] **123 S. Ct.** 1513, 155 L.Ed.2d 585 (2003).

[2] 512 U.S. 415 (1994).

[3] 517 **U.S.** 559 (1996).

[4] ***Westerbeke Corp. v. Daihatsu Motor Co., Ltd.,*** 304 F.3d 200,208 (2d Cir. 2002); ***see e.g. GMS Group, LLC v. Benderson,*** 326 F3d 75, (2d Cir. 2003); ***Sawtelle v. Waddell & Reed,*** 754 N.Y.S.2d 264,269-70 (1st Dep't 2003).

[5] The Court also remanded the punitive damages issue to the panel **for** reconsideration of its award. On September 5,2003, **the** panel reconfirmed the full $25 million award. It would be surprising if Waddell did not submit a motion to vacate the panel's decision.

[6] **83 F.** Supp.2d 413 **(S.D.N.Y.** 2000).

[7] 7 F. Supp.2d 151 (1998).

In Brief

NASD ANNOUNCES SETTLEMENT MONTH 2003: ***In a News Release, dated September 24, 2003, NASD kicked off its annual mediation "sales" event, in which parties in dispute are offered "special incentives to try mediation as an alternative to arbitration."*** Significantly reduced rates await those who arrange to mediate during October in any of NASD's mediation centers (those locations are map-designated on the NASD-DR WebSite). Mediators have agreed to reduce their usual hourly rates during Settlement Month and NASD will reduce by one-half its normal mediation filing fees. For example, the cost of mediating a dispute involving more than $100,000 will drop to $500 per party for an 8-hour mediation from the usual range of $800 to $2,000 per party. This is the seventh annual Settlement Month; NASD's mediation program marks its eighth anniversary in 2003. During that time, the process has been utilized by parties in over 8,500 cases and has achieved settlements in approximately 80% of those matters. *(ed: NASD is also one of the sponsors of Mediation Settlement Day in New York, scheduled this year for October 30, 2003. Mediation Settlement Day is organized by the Association of the Bar of the City of New York and is co-sponsored by a coalition of public service organizations, bar associations, law schools, and courts. Honorary Chair of this year's event will be Hon. Janet Reno, who will speak at the ABCNY about "The Promise of Mediation" on October 21, 2003 at 7 PM.)*

UPDATE, RAPOPORT v. THE FLORIDA BAR: ***The Florida Supreme Court's determination (see SAA 03-08) that an attorney licensed out-of-state may not represent parties in arbitration has been challenged in a petition for certiorari filed with the U.S. Supreme Court.*** The Florida Supreme Court acted in February 2003 (SLA 2003-09) to enjoin Albert A. Rapoport, a member in good standing of the Bar of the District of Columbia and the U.S. Supreme Court, from engaging in the unlicensed practice of law. The Court's ruling was based upon Mr. Rapoport's engaging within the State of Florida in the representation of parties in securities arbitration proceedings and in advertising his services in Florida newspapers. Mr. Rapoport was denied a rehearing in May 2003 and, with time granted to extend, he filed a petition for ***certiorari*** at the end of August. The Petition presents two questions, which challenge the ruling as conflicting with: (1) "federal practice and tasks which are incidental to the preparation and prosecution of federal securities arbitrations under the Securities Exchange Act;" and (2) the Federal Arbitration Act, by restricting "arbitration practice by qualified attorneys as defined by arbitration agreements approved by the NASD and NYSE within the State of Florida." The Petition calls the Florida Supreme Court's decision "a 'trap door' sprung on federal practice specialists" and points to the new ABA Model Rules, which "now call for reciprocal bar admission on motion for experienced attorneys and reciprocal discipline enforcement." It concludes that the decision "usurps federal law" and "infringes upon the authority of the SEC" and should be reviewed by the Court as "the sole check and balance on the decision appealed." The Petition was submitted on Mr. Rapoport's behalf by Joseph R. Giannini, National Assn. for the Advancement of the Multijurisdictional Right to Counsel (Los Angeles), and Ainslee R. Ferdie, Attorney at Law (Miami). (SAC Ref. No. 03-36-02)

NEW JERSEY BAR RULES AMENDED: ***Coincident with the move by NASD to establish a New Jersey hearing situs, the New Jersey Supreme Court has just announced material changes to the Rules on Law Practice.*** The changes are set forth and explained in a 114-page document, entitled "Administrative Determinations in Response to the Report and Recommendation of the Supreme Court Commission on the Rules of Professional Conduct,'?which the Court issued under date of September 10, 2003. The changes revamp many sections of the professional *code* as part of a process that began in January 2001 with the creation of the "Pollock Commission." The Pollock Commission was directed by the Court to review the New Jersey Rules in light of changes made by the ABA "Ethics 2000 Commission.?'The Court also responded to recommendations made by the *Ad Hoc* Committee on Bar Admissions, also called the Wallace Committee. Regarding out-of-state attorneys not licensed in New Jersey, the new RPC continues a set of special conditions for in-house counsel, which are contained in R. 1:27-2, and establishes new terms in R. 5.5(b) and (c), applicable to all out-of-state lawyers, for practice within the state. R. 5.5(b)(ii) specifically mentions arbitration and mediation, indicating that non-admitted attorneys may engage "in representation of a party to a dispute by participating in arbitration, mediation or other alternate or complementary dispute resolution program, [if] the representation is on behalf of an existing client in a jurisdiction in which the lawyer is admitted to practice, and the dispute originates in or is otherwise related to a jurisdiction in which the lawyer is admitted to practice." There is a broader exemption for occasional practice, where disengagement of the lawyer would be inefficient, impractical or detrimental to an existing client. R. 5.5(c) makes plain that all non-admitted lawyers practicing in New Jersey will be subject to the RPC, the Court's disciplinary jurisdiction, and service of process upon the Clerk of the Court as a lawyer's or law firm's agent. A major barrier to practice for lawyers based out-of-state has been dropped at the Wallace Committee's recommendation, as an experiment. Even if an out-of-state lawyer were licensed in New Jersey, R. 1:21-1(a) erected a "bona fide office" requirement that obligated attorneys to maintain an actual office in New Jersey, as opposed to a "mail drop" location. The "Determinations" Report states: "The Court also opted to amend the *bona fide* office Rule *(R.* 1:21-1(a)) in the form recommended by the Wallace Committee. That

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amendment, and the multijurisdictional practice RPC, will be evaluated at the end of three years. At that time, the Court will have its Professional Responsibility Rules Committee prepare a report and recommendations. Ultimately, the Court will decide whether to retain or modify the current amended language." *(ed: We found the 114-page Report at this URL: http://www.judiciary.state.nj.us/notices/index.htm. SAC thanks to Don Davidson, Bingham Dana, NYG, for alerting us to an article on the "bona fide office" change in the NY Law Journal (see Law.Com, 9/15/03)).* (SAC Ref. No. 03-36-03)

PCX RULE CHANGE: ***On July 9, with an amendment filed on August 13, 2003, the Pacific Exchange (PCX) made changes to its arbitration program, which, in the current environment in California, will protect its program from unnecessary legal risk.*** The PCX earlier received SEC approval of rule changes that permitted the Exchange to require waivers from parties of the California Standards and of legislation that might arguably apply to the Exchange's arbitration forum. In the current rule change, which the SEC approved on August 15, 2003 (SEC Rel, 34-48351), the Exchange expands these waiver requirements to all arbitrations filed with the forum and adds the caveat that, if a party should refuse to sign the waivers, "the Exchange will decline jurisdiction over, dismiss and refund fees paid to PCX or PCXE by the parties." The Commission allowed a time for public comment in the Federal Register announcement (68 Fed. Reg. 163, p. 50823 (8/22/03)) which ended September 12, 2003 (refer to File No. SR-PCX-2003-34), but it also deemed the rule change eligible for accelerated approval. *(ed: The August 13 amendment, which the SEC evidently requested, undertakes to pursue disciplinary action against any industry party who **refuses** consent to the waivers. The PCX approach, which will reject the arbitration filing without waivers, may end up assisting plaintiffs who want to avoid arbitration. It makes performance of the contract to arbitrate, to the extent PCX is the chosen forum, impossible to perform.)* (SAC Ref. No. 03-34-01)

NASD SEEKS PUBLIC COMMENT ON SUPERVISION PROPOSAL: ***The NASD Board of Governors has approved seeking public comment on the prospect of rulemaking that would heighten supervisory requirements for firms employing certain brokers.*** A press release on the NASD Regulation WebSite announces the NASD Board's intent to target brokers with a number of regulatory actions, customer complaints or other incidents of concern. According to the press release, the proposed amendments that the Board is considering would require: (1) heightened supervision of brokers who, "within the last five years, have had three or more customer complaints and arbitrations, three or more regulatory actions or investigations, or two or more terminations or internal firm reviews involving wrongdoing." (2) a written plan for supervision to be signed and acknowledged by the broker's supervisors. "Currently," the release notes, "...neither federal securities laws nor NASD rules explicitly address firms' supervisory obligations for individuals who have a history of regulatory actions or customer complaints but who fall short of triggering statutory disqualification provisions." This plan, which will amend Rule 3010 on "supervisory Systems," would fill that gap. *(ed: The text of the rule proposal appears in a September 2003 Notice to Members. NTM 03-49 describes the proposal in full and sets a **deadline** of October 10, 2003 **for comments.** According to NTM 03-49, an estimated 29,500 brokers "out of the 663,000 persons currently registered with NASD,,, have been subject to one or more customer complaints and arbitrations within the last Jive years. Of this number, 2,751 persons (.41 percent of all registered persons) have had three **or** more complaints and arbitrations.")* (SAC Ref. No. 03-34-02)

SEC SEEKS COMMENT ON NASD PDAA RULE: ***On September 12, 2003, the Federal Register published a rule proposal for comment that will substantially revise the pre-dispute arbitration provisions currently in use by broker-dealers.*** SR-NASD-98-74 sets forth substantive requirements that broker-dealers will have to meet in drafting arbitration agreements between customers and themselves. Because some of those requirements anticipated rule proposals on punitive damages and six-year eligibility that have since been withdrawn or overhauled, the PDAA-requirements rule has not been acted upon by the Commission. NASD proposed in an amended filing that was submitted on August 22, 2003, to de-link the Rule 3110(f) change from the other filings and to set a new effective date. That new effective date will be established within 60 days of the Rule's approval by an announcement in a Notice to Members and the announcement will make the Rule effective within 90 days of the NTM's publication. The publication Release, SEC Rel. 34-48444 (dtd. 9/4/03), explains that the Rule was previously published for comment in 1999. Since that time, two amendments have been made, so the Commission is now publishing the amended proposal for comment. Revisions to NASD Rule 3110(f) will add new language to the highlighted disclosures* that must appear in the PDAA section of customer agreements and will increase the number from five to seven. As before, the Rule requires a copy of the agreement to be given to the customer, who must also acknowledge receipt thereof on the agreement or on a separate document. The new rule clarifies that these events must take place at the time of signing. A customer will have the right to receive, upon request, a copy of the agreement and information about the rules of the available arbitration forums. This latter provision applies to all customers regardless of when they signed their PDAAs. The "no-limitations" section of Rule 3110(f) will include a new provision that prevents limitations on the filing of claims in court that are permitted "to be filed in court under the rules of the [seiected] forums...." A new subsection (B) prohibits members from enforcing a choice-of-law provision that has an insubstantial nexus between the governing law and the dispute or the parties. An anti-bifurcation provision will allow a customer to avoid having only some, but not all, of the claims in his/her court action moved to arbitration. This should short-circuit attempts to pare the claim through motion practice on timeliness or other grounds before the member moves for arbitration. The applicability of the new requirements, except for the customer-request provision, is prospective, with the caveat that "agreements signed by a customer before (effective date) are subject to the provisions of this Rule in effect at the time the

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agreement was signed." Comments were due to be submitted to the Commission by October **3,** 2003. *(* they used to be disclosures, but that word has been deleted in the new text and the parties* ***now*** *"agree" to the language. That change accommodates "disclosure"(G), a substantive provision that provides that "[t]he rules of the arbitration forum in which the claim is filed, and any amendments thereto, shall be incorporated into* ***this*** *agreement." The "any amendments" phrase refers* ***back*** *to the forum's "rules," not* ***to the*** *"claim.")* **(SAC** Ref. No. 03-37-02)

SIA COMMENTS ON CLASSIFICATION RULE: ***The Arbitration Committee of the Securities Industry Association submitted comments on the NASD proposal to amend the criteria upon which public and non-public arbitrators are classified.*** Under the signature of Edward Turan, Chair of the SIA Committee, a five-page letter, dated September 11, 2003, expresses support for many of the changes offered by **NASD** to Rules 10308 and 10312 (see SAA 03-33), but expresses specific disagreement with certain modifications that render the proposed changes "overreaching and potentially detrimental to the depth of the NASD arbitrator pool." The "overreaching" commentary focuses upon the proposed 10% threshold. It is "too low," in SIA's view, if the aim is to eliminate from the "public arbitrator" category those with "' significant ties"' to the industry. The proposal excludes those "professionals" whose **"firm"** derives 10% of its annual revenue from business transactions with the securities industry. **SIA** points out that plaintiffs' attorneys representing brokers in arbitrations <u>against</u> members would be thereby eliminated and offers several other examples of anomalous results. Most of these individuals will no longer qualify as "nonpublic arbitrators," so "their exclusion as 'public arbitrators' means they will be unable to serve as arbitrators at all." **NASD** has neither quantified what those losses will be, nor defined the impact on its arbitrator pool. The term "professional," while it exists in the current rule, must be better defined, given its proposed use as a boundary determinant between people employed by a "10% firm" who can serve as "public arbitrators" and those who cannot. Finally, SIA points out, the need to determine revenue percentages within an entire **firm** is certain to lead to "protracted and cumbersome information requests." The "public arbitrator" ranks will also be shorn of those who are related to industry personnel, far more distantly than before, even when the relative is not in the same household or in any way financially interdependent with the arbitrator. "No credible evidence," **SIA** states, "supports banning adult children **and** stepchildren from arbitrator service based solely on the fact that their parents or stepparents might once have been employed, in one capacity or another, by a broker-dealer." *(ed: Many of these points agree with those made* in *Prof. Katsoris' article,* this **issue.** *NASD responded to the SIA comments and others filed* **by** *NELA and PIABA in a comment letter to the Commission in early October, declining to change any aspect of the* ***proposed*** *rule.)* **{SAC** Ref. No. 03-36-04)

NYSE STATS, ***8/03: For the first time since a surge in NYSE arbitration cases began in 2000, the aggregate number of new filings is down substantially from the year-earlier figures.*** Last month **(SAA** 03-31), in our report on NYSE arbitration statistics through July 2003, we noted that the 715 filings submitted in 2003 were just a bit below the 738 filings submitted during the first seven months of 2002. In August, though, the difference widened considerably, with 781 filings submitted through August 31, 2003 (i.e., 66 for 8/03) compared to **831** filings through August **3** 1, 2002 (i.e., 93 for 8/02). There were 572 customer-related claims among the 781 filings through August 2003, which compares somewhat anemically to ***665*** customer-related filings among the 83I cases submitted through August 2002. The kinds of cases that are presumably causing the filing bulge over at the **NASD,** such as tech-wreck, analyst conflict, stock option, mutual fund, **and** other Market 2000 cases, are not by any means restricted to NASD-only members, so the decline in customer filings seems to be running against the tide. NYSE remains faster and cheaper than arbitration at **NASD,** so the apparent statistical trend is perplexing. *(ed: Readers can find the NYSE statistics at <u>www.nyse.com/arbitration</u> under* ***"News & Updates."****)*

UPDATE, SAWTELLE v. WADDELL & REED, INC., NASD ID #97-03642 (9/4/03). ***Incredibly, the three Arbitrators who were directed to reconsider an excessive award of punitive damages have done so and have decided that they were right after all!*** Persuaded, perhaps, that the New York Appellate Division's vacatur of the Panel's $25 million punitive damages award may have occurred because they did not provide an explanation in support, the Panel re-affirmed its original ruling and stated the following: Respondents are "liable, jointly and severally, **to** Claimant for punitive damages in the amount of $25,000,000 (twenty-five million dollars **US).** The Panel awards punitive damages under CUTPA [Connecticut Unfair Trade Practices Act] **as** it found that Respondents Waddell & Reed **and** Robert Lee Hechler through agents of Waddell & Reed demonstrated reprehensible conduct that warrants an award of punitive damages. The Panel further found that **after** claimant was terminated, Respondents orchestrated and conducted a homble campaign of deception, defamation and persecution of Claimant which included, among other things: giving clients the impression that claimant mishandled their investments; Claimant was untrustworthy; Claimant was no longer in the business; Claimant was not authorized to do business; and, Claimant was in some way involved in criminal activities and the embezzling of client funds. **The** Panel also found that **Respondent** Waddell & Reed, through its agents, re-routed Claimant's mail **and** his telephone lines; as a result, telephone calls and mail intended for Claimant were received by Waddell & Reed and its agents." While these findings were not in the original Award, **the** charges were known ***to*** the Appellate Division **when** it found the $25 million award "grossly excessive" in February 2003 **(SAA** *03-04).* Referring to **the** proportionality standards developed by the **U.S.** Supreme Court in *BMW v. Gore,* 517 U.S. *559,* the Court ruled that constitutional due process standards, while not directly applicable to arbitrations, serve as benchmarks for determining that which is "arbitrary and irrational under the **FAA,"** Applying the ***Gore*** factors, the Court observed that the termination and post-termination conduct that quickened the Arbitrators' ire did not ultimately affect anyone's health or safety. The

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dispute, which arose in 1997, was of limited duration, did not impact Mr. Sawtelle's earnings significantly, and did not impair his ability to retain clients and gain subsequent employment. The Court terms it an "ordinary commercial dispute," with no widespread impact, that primarily affected only two parties. The punitive award, which was expressly granted under the Connecticut Unfair Trade Practices Act, was the largest on record, whether in litigation or arbitration, and, with a **23** to **1** ratio, was "well above the four-to-one ratio that **the** Supreme Court regards as 'close to the line"' and the two-to one ratio more common in **CUTPA** cases. In monetary terms, the largest award of punitive damages under CUTPA in a Connecticut state court is only $168,000 and in federal court less than $1 million (See **SLA** 2003-07 **for** a further summary). According to the supplementary Award, the Claimant urged the Panel **"to** leave its original award of punitive damages as is." Respondents maintained that "the Appellate Division's factual findings and legal holdings are binding on the Panel" and requested "that punitive damages in this case not exceed $400,000 or an "absolute maximum amount," under the Supreme Court's intervening *State Farm* decision of $1,080,499. *(ed: We're speechless. The Wall Street Journal (online ed., 9/8/03) reports that Waddell & Reed "plans to appeal the ruling." Stay tuned!)* **(SAC** Ref. No. **03-36-01)**

ANALYST CONFLICTS AS SECURITIES FRAUD: ***Another federal court (see SAA 03-25) has dismissed claims charging analyst conflicts during the tech-stock bubble, ruling the Rule lob-5 class action claims both untimely and flawed.*** This one was decided in New Jersey federal court and concerned **a** specific analyst's alleged conflicts in recommending the purchase of a specific tech-stock, Qualcomm, Inc. The Court in *Ward v. UBS PaineWebber, Inc.*, No. 02-3878(JAP) (9/10/03) (summarized in **SLA** 2003-37), held that an analyst's predictions in December 1999 that Qualcomm would hit $1,000 per share within a year were not so "outlandish" as to presume their falsity. First, the alleged misrepresentation was a prediction, not a statement of fact, and, as such, it was a forward-looking statement. Forward-looking statements are more protected than statements of fact and may not be presumed false, unless they were not "genuinely and reasonably believed when made." Qualcomm actually hit $800 per share **and** "skyrocketed" 300 points to get there in a short period of time. The prediction, then, was not so unreasonable that the analyst had to know it was false. Similarly, the concepts of "motive and opportunity" from which one can infer scienter are also too weak to stand. The alleged motives were to get publicity for the firm and attract investment banking business, motives that the Court recognizes are simply competitively based. Finally, the claims **are** time-barred, even if one applies the two-year limit allowed under the new (8/02) Sarbanes-Oxley Act. *(ed: We just finished reading the February 2003 decision written **by** SDNY Judge Scheindlin in the **massive*** IPO Securities Litigation *case (the Opinion is massive, too). There, motions to dismiss analyst conflict charges are denied, but the Complaint makes the allegations part of an **overall** manipulation and fraudulent scheme that includes a variety of tie-in arrangements, trade-laddering in IPO after-markets, and undisclosed compensation in the form of rebates and excessive commissions. Summary, SLA 2003-37)* **(SAC** Ref. No. 03-37-01)

PITTS v. CITIGROUP GLOBAL MARKETS, INC. (fka Salomon Smith Barney), NASD ID #02-03880 (New Orleans, 9/4/03). ***A sophisticated customer's claim involving Global Crossing and the research reports of Salomon Smith Barney analyst Jack Grubman are dismissed by the Arbitrators for failing to establish falsity and reliance.*** The "Case Summary" of this Award gives no clue that this is, at least in part, an "analyst conflict" case; fortunately, the Panel chose to include findings and explanations that add instructive value to this Award. The "Case Summary" alleges breach of fiduciary duty, misrepresentations and omissions, unsuitability and unauthorized trading in two stocks, Global Crossings and United Companies. The unauthorized trading allegation related to the United Companies purchase, which "the Panel concludes ... was authorized **and** that [the broker] acted reasonably and appropriately in the interest of his customer." The Global Crossings claim was aimed more at **SSB** and Mr. Grubman, but, again, the Panel finds the evidence insufficient, "Claimant failed to establish that any of the reports complained of contained **any** misrepresentation or inaccuracy or that the opinions expressed by Salomon Smith Barney's analyst were not justified by available data. To the contrary, the uncontradicted testimony of the expert witness offered by Respondents establishes that the reports evidence a sound **and** acceptable methodology well supported by reliable data and that the opinions expressed were widely held by other firms and rating services. In any event, Claimant's testimony that he relied exclusively on the rating of Salomon Smith Barney's analyst is not credible. Claimant is a sophisticated investor who considered many sources in reaching his investment decision, including analysis by other firms and conversations with professionals, family and friends.'' In a pre-hearing discovery order, the Chair directed defense counsel to determine Mr. Grubman's availability for telephonic testimony during the hearing two weeks hence. The Chair also provided that, absent his availability, the Panel could determine at the end of the presentation **of** other evidence whether to re-convene to hear the Grubman testimony. Claimant did move, at the close of the case, for that continuance. In the "Other Issues" section of the Award, the Panel explains that "Claimant sought to explore whether Salomon Smith Barney's analyst might have allowed improper motives to influence his evaluations of Global Crossing, Ltd. Considering the argument **of** counsel and the evidence adduced at the hearing, the Panel concluded that Claimant failed to establish that Mr. Grubman's testimony might provide material information relevant to the issues of the case. Accordingly, the motion was denied." The Panel split the fees between Claimant and Citigroup and, "[c]onsidering the Panel's conclusion that Respondent Gardner did not effect an unauthorized transaction in the Claimant's account," the Panel granted the broker's request for expungement **of** his CRD. *(ed: **Respondents were** represented by Florida counsel in this Louisiana-based arbitration, Bradford D. Kaufman and Todd A. Zuckerbrod, Greenberg Traurig, **P.A.**, West Palm Beach, **FL.** The Award **is** available online at scan.cch.com/ScanPlus. Enter the case number, 02-03880, in the **Search** window and click "search.")* ■

Articles & Case Law

As a regular feature, SAC summarizes articles and case decisions of interest in the field of securities/commodities arbitration law. If you find one we missed or are involved in a case that produces an interesting decision, please write and send us a copy. ***As it is our objective to cover all relevant decisions, we will sometimes include decisions in the current "Articles & Case Law" section that issued a year or more ago. We also summarize unpublished decisions and orders. For these reasons, readers are cautioned to cite-check cases to assure they have not been overruled and may be cited in accordance with local court rules.*** **We thank our readers who have contributed court opinions and who, by their efforts, help us all to keep informed. Credit is given to contributors at the end of the relevant case summaries.**

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Lawmakers Urge Reforms in Brokerage-Industry Arbitration, by Judith Burns, WALL ST. JNL. (online ed., 9/25/03) (Reps. Markey and Dingell follow GAO Report with demand for end to PDAAs in employment disputes).

Lawyers Bringing Investor Complaints Seek NYSE Board Seat, by Phyllis Plitch, WALL ST. JNL. (online ed., 9/19/03) (PIABA calls for greater investor representation in the NYSE's boardroom).

NASD National Mediatian Month Could Work in Firm's Favor, by David Serchuk, SECURITIESWEEK, Vol. 30, No. 39 (9/29/03), p. 9 (Because there's no transcripts or discovery, firms favor mediation).

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Sarbanes-Oxley Could Disrupt Accepted Corporate Custom of Paying Certain Officer Legal Fees, by Joe Hutnyan, SECURITIESWEEK, Vol. 30, No. 39 (9/29/03), p. 10 (SOXA limits loans, so advancing legal fees could be problematic),

SEC Approves New PCX Arbitration Rule, WALL ST. LETTER, Vol. 35, No. 34 (8/25/03), p. 6 (Pacific Exchange rule allows forum to reject parties if they refuse to sign California waiver).

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Mini-Summations Yield Benefits in Complex Multiday Arbitration Cases, by Michael S. Oberman, METROPOLITAN CORPORATE COUNSEL (Aug. '03), p. 8.

Open Questions Regarding Non-Party Discovery in Commercial Arbitration, by John L. Watkins, METROPOLITAN CORPORATE COUNSEL (Jun. '03), p. 9.

Regulators Turn Up the Heat on Hedge Fund Industry, by Ernest E. Badway, METROPOLITAN CORPORATE COUNSEL (Jun. '03), p. 29.

The Securities Analyst as Agent: Re-Thinking the Regulation of Analysts, by Jill E. Fisch and Hillary Sale, IOWA L. REV., Vol. 88, No. 5 (May '03), p. 1035.

Suitability Claims for Investors Who Hold: The California Bloom is Off the Rose, by C. Evan Stewart, SEC. REG. & LAW REP., Vol. 35, No. 29 (BNA, 7/21/03).

Short-circuiting Judicial Challenges to Arbitral Agreements Under New York Law, by Richard A. DePalma and Peter D. Sharp, METROPOLITAN CORPORATE COUNSEL (Jun. '03), p. 23.

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The Scope of Arbitration Clauses: Do They Also Bind Individual Directors, Officers And Employees? **By** Steven H. Reisberg, METROPOLITAN CORPORATE COUNSEL (Sep. '03), p. 17.

Third Circuit and New Jersey Appellate Division Decisions Expand Employers 'Potential Vicarious Liability ***for*** *Workplace Harassment by Supervisors – Part I,* by Edward Cerasia II and Magdale Labbe, METROPOLITAN CORPORATE COUNSEL **(Sep. '03), p. 13.**

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SUMMARY OF DECISIONS

(ed: The court decisions summarized below are arranged by major subject heading first and digested ***in*** *a single sentence. This enables readers to quickly refer* to *the courts or topics that are of key interest. The decisions are then arranged in alphabetical order by Plaintiff and summarized more fully. Bold-type headnotes also facilitate quick scanning* ***for*** *topics or issues of interest. Generally speaking, these case synopses* ***were*** *prepared for SAC's other newsletter service, the* Securities Litigation Commentator/Alert (SLC) *and have been previously published in that service's weekly e-mail alert service ("LitAlert"). Where the synopsis has been written by one of SLC's Contributing Editors, the author's first initial and last name appears at the end of the summary.* **We** *thank the SLC Contributing Editors* ***for*** *their assistance in providing these case summaries.)*

AGREEMENT TO ARBITRATE: *Whether there is fraud inducing a customer to execute an arbitration agreement or not is a determination for the court.* FAZIO v. LEHMAN BROTHERS **(6th Cir.)**

AGREEMENT TO ARBITRATE: *If the parties admit to the existence of an agreement to arbitrate, the agreement itself need not* ***be*** *submitted.* WHITFIELD & INVESTMENT CENTERS OF AMERICA, IN **RE (TX App., 9Dist.)**

ARBITRABILITY: *Claims for injunctive relief under the California Business and Professions Code Section I7200 are not arbitrable.* WAUL v. CHARLES SCHWAB & CO. **(CA App., 1Dist.)**

AWARD CHALLENGE: *The court may vacate an arbitration award only if the award* ***is*** *completely irrational, exhibits a manifest disregard* ***of*** *law or otherwise falls within one of the grounds set forth in the Federal Arbitration Act.* COUTEE v. BARRINGTON CAPITAL **GROUP (9th Cir.)**

AWARD CHALLENGE: *Vacatur petitions need not be granted evidentiary hearings if the arguments lack merit or a hearing would be legally unnecessary.* MAMANDUR v. POWER & PRUDENTIAL SECURITIES **(8th Cir.)**

CLASS ACTIONS, EFFECT OF: *A collective action under the FLSA is not the kind* ***of*** *"class action" addressed under the exclusionary provisions of the SRO arbitration rules.* CHAPMAN v. LEHMAN BROS., INC. (S.D. **FL)**

JURISDICTION ISSUES: *Although Section 4 of the Federal Arbitration Act appears to confer jurisdiction on federal courts to issue motions to* ***compel*** *in cases where the court* ***would*** *have jurisdiction of the underlying claims, a strong body of case* ***law*** *has developed holding that the nature* ***of*** *the underlying dispute* ***is*** *irrelevant* ***for*** *purposes of subject matter jurisdiction and that the motion must invoke diversity or federal question jurisdiction.* ABN AMRO SAGE CORPORATION v. PTI CAPITAL MANAGEMENT, LLC **(N.D. IL)**

JURISDICTION ISSUES: *Customers of* **a** *broker-dealer's registered representative are customers of the firm and disputes that arise* ***from*** *the registered representative's activities arise in connection with the broker-dealer's business even if securities are not involved.* DAUGHERTY v. WASHINGTON SQUARE SECURITIES, INC. (W.D. PA)

JURISDICTION ISSUES: *Arbitrators are not* ***free*** *to dismiss a matter from arbitration and refer it to court, where a valid agreement to arbitrate exists.* **FUTTERMAN v. MORGAN STANLEY (CA App., 2Dist.)**

LIABILITY ISSUES: *Under New York law, a* de facto *merger analysis requires continuity of ownership.* RYAN BECK v. FAUST **(W.D. PA)**

MANIFEST DISREGARD: *When a panel issues a written decision and there is no rational explanation* ***for*** *the basis of the decision, then the award can be vacated on grounds of manifest disregard of the law.* **HARDY v.** WALSH MANNING **SECURITIES,** LLC **(2nd Cir.)**

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REPRESENTATION ISSUES: *Ineffective assistance of counsel is not among the specified grounds for vacating an award under the Federal Arbitration Act.* CONGRESSIONAL SECURITIES, INC, v. FISERV **SECURITIES,** INC. **(S.D. NY)**

SANCTIONS: *Either an intent to delay or bad faith must be proved to obtain an attorney fee award, unless the challenge is totally frivolous.* FTP SECURITIES **v.** GARRETT **(CA Super. Ct.)**

SELLING AWAY: *An agent or representative of a financial service* ***firm is*** *an "associated personÓ under* ***NASD*** *Rule 10301(a), such that a relationship with the agent entitles the investor to the arbitration process.* **FINANCIAL** NETWORK INV. **CORP.** v. THIELBAR **(E.D. IL)**

STANDARD OF REVIEW: *An Appellate Court sitting* en banc *is not bound by the "law of the caseÓ doctrine. The FAA* ***does*** *not permit heightened judicial review of Awards, simply because* ***the*** *parties contracted for* it. KYOCERA v. PRUDENTIAL-BACHE **SECURITIES (9th Cir.)**

TIMELINESS ISSUES: *Section 205(a) of the NY Civil Practice* ***Law*** *& Rules, where applicable, allows* ***six*** *months in which to file a motion to vacate, despite the 90-day limitation of Section 7511(a).* HAKALA v. **DEUTSCHE** BANK **(2nd Cir.)**

VACATUR OF AWARD: *Once a violation of the state securities statute is found, the tribunal has no choice but to award damages* ***as prescribed*** *in the statute.* ALLISON v. MERRILL LYNCH, PIERCE, FENNER & **SMITH, INC. (FL Cir. Ct.)**

WAIVER: *Participation in court proceeding* ***for*** *two years, especially where depositions* ***are*** *taken, will bar defendant from seeking to compel arbitration one month before trial.* HALE v. PRO **EQUITIES (AL Sup. Ct.)**

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ABN AMRO Sage Corporation v. PTI Capital Management, LLC, 02 *C* 5256 (N.D. Ill., 8/19/03). **Declaratory Judgment Act * FRCP (Rule12(b)(1); 65) * Jurisdiction(28 U.S.C. §§ 1331) * FAA (§ 4) * SRO Rules (NASD Rule 10301 "Customer") * State Law, Applicability of.**

Defendant PTI Capital Management, LLC ("PTI") filed a Statement of Claim for arbitration with **NASD** **Dispute** Resolution, Inc. **("NASD')** against Plaintiff, **ABN AMRO** Sage Corporation ("Plaintiff'), alleging, *inter alia,* violations of Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act") and Securities Exchange **Commission** ("SEC") Rule lob-5. Plaintiff, by virtue of its **NASD** membership, agreed to comply with the rules of the **NASD,** including those involving arbitration. Plaintiff then filed a Complaint for declaratory and injunctive relief pursuant to the Declaratory Judgment Act **(28 U.S.C.** § 2201) and Rule 65 of the Federal Rules of Civil Procedure ("FRCP), against **PTI** and **NASD** Dispute Resolution, Inc. **("NASD').** The **NASD** has since been voluntarily dismissed from this action. Plaintiff brought this Complaint to stay the arbitration, alleging that PTI is not **a** customer under **NASD** Rules and that Plaintiff should not be compelled to arbitrate under the Federal Arbitration Act **("FAA").** PTI then moved to **dismiss** the complaint under FRCP Rule 12(b)(1) for lack of subject matter jurisdiction. Plaintiff argued that ***Section*** 4 of the **FAA** allowed the district court to look to the underlying claims in the arbitration to determine the existence of a federal question for purposes **of** jurisdiction under 28 **U.S.C.** § **1331** and, in that regard, PTI's arbitration claims were based upon Section 10(b) of the 1934 Act and Rule lob-5. In granting PTI's Motion to Dismiss, the Court concludes that Section 4 of the **FAA** does not confer federal question jurisdiction. Plaintiff's Complaint **for** declaratory and injunctive relief **to** stay arbitration was created by **a private** contract agreeing to arbitrate under the rules of the **NASD;** thus, resolution **of** the Complaint involves the mere interpretation of the **NASD** rules. Such contract disputes are governed by state law, not federal law, and it is irrelevant whether or not **PTI's** arbitration claims were federal claims. *(P. Michaels)* **(SLC** Ref. No. 2003-35-03)

Allison v. Merrill Lynch, Pierce, Fenner & Smith, Inc., Case No. 03-CA-1532 (Fla. Cir. Ct., 9JC., 9/25/03). **Award Challenge * Vacatur of Award * Remand to Arbitrators * Damage Calculations * Attorney Fees * Manifest Disregard of Law * State Statutes Interpreted (Fla. Stats. §517.301) * FAA (§10 "Exceeding Powers").** *Once a violation of the state securities statute is found, the tribunal has no choice but to award damages as prescribed* ***in*** *the statute.*

Arbitrators so often fail to award a damage amount that deviates from the prescribed formula set out in the state securities statutes that some arbitration attorneys will drop all claims but the state securities claim at the end of their case. That forces the arbitrators' hand, since any award of damages must be based upon a violation of the statute, meaning the damages awarded must **follow** the statutory formula. In this case, Claimant did not drop his other claims, **but** the Arbitrators specifically based their $1.00 award upon "Respondent's violation of the Florida Securities and Investor Protection Act" **(NASD** ID #01-05877, Tampa, 1/21/03). They also awarded $20,000 in attorney fees, based upon **that** statutory

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violation, but, unassuaged, Claimant sought vacatur. In Florida, the latter responsibililty is generally left to the courts, so the Court vacates the attorney fee award. "The parties do not dispute that the arbitrators exceeded their authority in awarding attorney's fees. Indeed, one arbitrator recognized the absence of authority in partially dissenting from the Award." The $1.00 damage award appears to have arisen from the Panel's application of a discount for market-driven losses, but the **FSIPA** does not allow for such discounts and counsel advised the Panel of that fact at hearing. "Thus, the three arbitrators – two of whom were attorneys – were plainly informed of the mandatory damage provision under the Florida Securities Act. Despite the fact that they limited their liability finding to that statute, the arbitrators awarded only a nominal compensatory figure that bore no relation whatsoever to the true size of Allison's losses." That act was a manifest disregard of the law and warrants vacatur. The matter will be remanded to the same Panel, "with directions to issue a new, amended award of such damages in accordance with Section 517.211 Florida Statutes." *(ed: To her credit, counsel for Merrill did not advise the Panel that it could apply a* ***market*** *discount if it found a state securities violation. She advised that such a calculation might* ***be*** *reached if liability were based upon a common* ***law*** *claim, but this Panel apparently did both: it found liability under* ***the*** *FSIPA and reduced* ***the*** *losses by some discount factor. The Court does not try to calculate the statutory damages, but Claimant maintained they exceeded $100,000. Neal J. Blaher, Attorney at* ***Law,*** *Orlando, FL, represented Claimant in both the arbitration and the post-Award proceeding.)* (SLC Ref. No. 2003-38-03)

Chapman v. Lehman Bros., Inc., 2003 WL 22053459, 2003 U.S. Dist. **LEXTS** 15201 (S.D. Fla., 8/26/03). **Federal Employment Statutes (FLSA $16) * Arbitration Agreement * SRO Rules * Class Action, Effect of * Statutory Definitions ("Class Action").** **A** *collective action under* ***the*** *FLSA* ***is*** *not the kind of "classaction"* ***addressed under the*** *exclusionary provisions of the SRO arbitration rules.*

SRO rules state that class actions cannot be brought in arbitration and they prohibit firms from enforcing arbitration agreements where the claimant is a member of a putative or certified class. **NASD Rule** 10301(d); NYSE Rule 600(d). **Ms.** Chapman sued "on behalf of herself and other similarly situated persons" for Defendant's failure to pay overtime compensation to sales assistants, wire operators, cashiers, and other clerical employees. Her claim was brought under section 16(b) of the Fair Labor Standards Act **("FLSA"),** 29 U.S.C. § 216(b). In contrast to most Rule *23* class actions, in a § 16(b) collective action, "no person can become a party plaintiff and no person will be bound by or may benefit from judgment un-

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less he has affirmatively 'opted into' the class; that is, given his written, filed consent." The Court holds that **FLSA** § 16(b) claims do not qualify as class actions for the SRO exception from arbitration. The meaning of "class action" under the **SRO** rules is read literally to refer to actions of the type governed by Rule 23, Fed.R.Civ.P. The employees' claims are therefore subject to arbitration. (C. *T. Mason: The Court's formalistic ruling ignores the administrative realities of a 16(b) case, including the possibility of sending notice to all the "similarly situated" employees. Opting in is a statutory right. The "similarly situated" requirement is "more elastic and less stringent than the requirements found in Fed.R.Civ.P. 20 (joinder)," Grayson v. K Mart Corp., 79 F.3d 1086, 1095 (11th Cir. 1996), or NASD Rule 10314(d).* **Also,** *in parsing what the SRO rules mean by class action, "i.e., class certification, decertification and exclusion, and opting out," the Court looked only to Rule 23(b)(3) and forgot that not all class actions have those characteristics. Rule 23(b)(1) and (2) classes are typically non-opt-out actions. There are conflicting authorities as to whether* ***FLSA*** *collective claims can be forced into arbitration at all. Contrast Louis v. Geneva Enterprises, Inc., 128 F.Supp.2d 912 (E.D. Va. 2000) (no arbitration for collective action, citing Barrentine v. Arkansas-Best Freight Systems, Inc., 450 U.S. 728, 739 (1981)), with Carter v. Countrywide Credit Industries, Inc., 189 F.Supp.2d 606 (N.D. Tex. 2002) (upholding arbitration agreement despite collective action, citing Gilmer v. Interstate/ Johnson Lane Corp., 500 U.S. 20 (1991)). This decision does not examine those questions at all.)* (SLC Ref. No. 2003-37-02)

Congressional Securities, Inc. v. Fiserv Securities, Inc., 02 Civ. 6593, 7914, 3740, 8364 **(JSM)** (S.D.N.Y., 7/15/03). **FAA (§10 "Postponement Refusal") * Confirmation of Award * Representation Issues * Waiver.** *Ineffective assistance of counsel is not among the specified grounds for vacating an award under the Federal Arbitration Act.*

Petitioners are a group of investors who maintained accounts at Congressional Securities, Inc. ("CSI") for whom Respondent, Fiserv Securities, Inc. ("Fiserv") acted as clearing agent. Each of the petitioners purchased shares of Interface Systems, Inc. ("Interface") on margin. The stock of Interface fell dramatically and Fiserv issued margin calls to Petitioners. When the margin calls were not honored, Fiserv commenced arbitration proceedings against Petitioners and ultimately received an award of $10,445,124.78 plus attorneys fees and interest. Petitioners then commenced this action to vacate the Award (**NASD** ID #00-03756 (NYC, 6/28/02)). Petitioners' principal claim is that the arbitrators improperly denied their request for a continuance on the morning of the scheduled hearing when new counsel appeared for them and requested additional time to prepare. Petitioners also contend that the arbitrators acted improperly when they permitted David H. Zimmer ("Zimmer") to act as Petitioners' attorney at the early stages of the proceedings even though he was a party to the proceeding and had been the broker for the other parties. In granting Fiserv's Motion to Confirm the Arbitration Award and denying Petitioners' Motion to Vacate the Arbitration Award, the Court holds that the arbitrators clearly acted reasonably in denying an application for a continuance made on the day of the hearing which had been scheduled more than seven months earlier. The proceeding had been pending for over a year and a half and, ten months prior, Petitioners were granted a delay to accommodate their counsel. The Court also notes that the arbitrators had issued a notice that they intended to proceed with the arbitration on the day scheduled unless a court ordered a stay. In regard to Zimmer's representation, states the Court, it is difficult to fault the arbitrators for not being sympathetic to Petitioner's argument regarding Zimmer's alleged involvement when it was never mentioned to them. Moreover, ineffective assistance of counsel is not among the specified grounds for vacating an award under the Federal Arbitration Act **("FAA").** Finally, the Court finds that all of the Petitioners were aware of the pending arbitration and had both actual and constructive notice of the hearing date. There was nothing before the arbitrators to suggest the application for a continuance was anything other than a last ditch effort to avoid a judgment for amounts legitimately due by bringing in new counsel. *(P. Michaels)* (SLC Ref. No. 2003-38-01)

Coutee v. Barington Capital Group, No. 02-56016, 2003 WL 21730625 (9th Cir., 7/28/03). **Award Challenge * Irrationality * Confirmation of Award * Manifest Disregard of Law * Exceeding Powers * Choice of Law * Attorney's Fees * Punitive Damages.** *The court may vacate an arbitration award only if the award is completely irrational, exhibits a manifest disregard of law or otherwise falls within one of the grounds set forth in the Federal Arbitration Act.*

The district court entered an order confirming the compensatory and punitive damages portions of an **NASD** arbitration award but vacating the attorney's fees. In remanding with instructions to enter an order confirming the arbitration award in its entirety, the Court of Appeals specifically holds that, under American Postal Workers Union v. U.S. Postal Service, 682 F.2d 1280 (9th Cir. 1982), cert. denied, 459 U.S. 1200 (1983), manifest disregard of *the facts* is not an independent ground for vacatur in the 9th Circuit. American Postal, the Court reasons, merely recognizes that, because the facts and law are often intertwined, an arbitrator's failure to recognize undisputed, legally dispositive facts may properly be deemed a manifest disregard of law. The Court also rejects Barington's argument that the arbitrators exceeded their authority in awarding punitive damages. Although the agreement contained a New York choice-of-law provision, the evidence at the arbitration hearing would support a punitive damages award under the more stringent standard in New York and the award

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was not "manifestly at odds" with New York law. With respect to attorney's fees, while New York law does not permit an attorney's fee award in the absence of express statutory or contractual authority, the Court of Appeals found that the district court overlooked the exception to the general rule that an arbitration panel may award attorney's fees, even if not otherwise authorized by law to do so, if both parties submit the issue to arbitration. *(W. Nelson: In rejecting manifest disregard of the facts, the Court noted that the 2nd Circuit in GMS Group v. Benderson has recently "clarified" that Halligan v. Piper Jaffray is based on the traditional manifest disregard of the law standard.) (EIC: The underlying Award, NASD ID #00-02444 (Los Angeles, 1/30/02), reflects, as the Court indicated, that both sides in their pleadings requested attorney's fees.)* (SLC Ref. No. 2003-33-02)

Daugherty v. Washington Square Securities, Inc., C.A. No. 03-183 (**W.D.Pa.,** 7/14/03). **Arbitrability * Award Challenge (Manifest Disregard; Exceeding Powers; Irrationality/Rational Basis) * Collateral Attack * Agreement to Arbitrate * Scope of Agreement * Selling Away * Supervision Issues * Statutory Definitions ("Customer").** *Customers of a broker-dealer's registered representative are customers of the firm and disputes that arise from the registered representative's activities arise in connection with the broker-dealer's business even if securities are not involved.*

On plaintiffs' motion to confirm arbitration award, broker-dealer moves to vacate on grounds that claimants were not customers of broker-dealer; investments were not "securities;" panel exceeded its powers in denying defendants' motion to dismiss 4 plaintiffs for lack of jurisdiction; and panel acted in manifest disregard of the law in finding that broker-dealer had duty to supervise its registered representative. Court confirms Award, finding that NASD Code requires defendant to arbitrate these types of disputes and panel did not exceed its powers or disregard law. Washington Square's registered broker sold plaintiffs unregistered promissory notes, payphone investments and equipment leases. Although Defendant did not receive any money for them, plaintiffs sued the broker-dealer when the investments defaulted. Four post-award issues are raised: (1) whether parties unambiguously agreed to permit arbitrators to decide if the parties agreed to arbitrate the dispute; (2) whether the court independently finds they agreed to arbitrate; (3) whether the panel exceeded its powers or (4) manifestly disregarded the law. The Court rules that the parties did not "clearly and unmistakably" agree to submit the issue of arbitrability to the Panel; thus, the question of whether the parties agreed to submit their disputes to arbitration is for the court to decide. It then independently finds that the parties' disputes were arbitrable because they fall within the purview of

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NASD Rule 10301. **NASD** Code 10301(a) requires members to arbitrate disputes between "a customer and a member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons. . . ." Here, the broker was a registered representative selling to his customers, albeit "away" from **WSS. NASD** Rule 10100 requires arbitration of claims such as defendant's obligation to supervise its representatives, which are "in connection with its business," with no requirement that the claim involve "securities." ***(S.** Anderson) (EIC: The underlying Award, **NASD** ID #00-04429 (Pittsburgh, 7/15/02), yielded **$329,600** on **a** $667,500* **claim.} (SAC** Ref. No. 03-32-01)

Fazio v. Lehman Brothers, No. 02-3820 (6th Cir., 8/13/03). **State Law, Applicability of * Agreement to Arbitrate * Enforceability (Mutuality; Forgery; Fraud in Inducement).** *Whether there is fraud inducing a customer to execute an arbitration agreement* ***or*** *not* ***is*** *a determination for the court.*

Defendants appeal from a District Court ruling denying arbitration on the grounds that the agreements to arbitrate do not "apply to the dispute." The lower court found that the alleged fraud (Ponzi Scheme) was not the type of matter covered **by** the agreements and that the agreements were in effect fraudulently obtained **(SLA** 2002-31). Following the reasoning of the landmark case, Prima Paint Corp. v. Flood **(388 U.S.** 395 (1967)), the Sixth Circuit holds that a fraud in the inducement to sign the agreement is for the arbitrators to decide, whereas fraud in the inducement to **sign** the agreement to arbitrate is for the courts. Therefore, this Court remands the case "for **a** determination of whether the arbitration clauses, analyzed independently from the account agreements, are valid." *(P. Hoblin: The Plaintiffs bear a difficult burden, as the arbitration clause is part of the customer's agreement and* is ***highlighted*** with *many warnings and disclosures.)* ***(EIC:*** *This is one of several Ohio-based litigations that deals with* ***the*** *massive misappropriations* ***by*** *former broker Frank Gruttadauria. S.G. Cowen Securities and Lehman Brothers, both of which employed Mr. Gruttadauria, recently* ***settled disci-*** *plinary charges related to his defalcations. In addition to paying fines of $5 million and $2.5 million, respectively, the brokerage firms also agreed to a special arbitration program to be operated by the* ***NYSE*** *(See our Arbitration Alert coverage of this matter, SAA 03-32.)* (SLC Ref. No. **2003-33-01)**

FFP Securities, Inc. v. Garrett, No. **GIC** 812852 (Cal. Super. Ct., 8/29/03). **Award Challenge * Confirmation of Award * Exceeding Powers * Sanctions (Judicial) * Attorney Fees) * State Law, Applicability of.** *Either an intent to delay or bad faith must be* ***proved*** *to obtain an attorney fee award, unless the challenge* ***is*** *totally frivolous.*

FFP Securities and its broker, J. Paul Escudero, lost in arbitration to Respondents, former customers **of** FFP who brought broad claims of mistreatment and negligence. The Panel awarded only $3,157 in compensatory damages, but charged the firm and the broker with $92,808 in commissions and fees, and $19,949 in "professional costs for services provided by Stephen C. Nill and Kevin Fehrmann" (presumably Claimants' experts). Petitioners object to the award of "professional costs" as unrelated to the narrow compensatory award, but the Court refuses to supplant its judgment for that of the Panel. It does examine more closely FFP's claim that some of the "commissions and fees" awarded related to a product that was not part of the dispute, a variable life insurance policy. The Court agrees that the "powers of an arbitrator are limited to the contested issues of law and fact submitted to the arbitrator for decision." Here, though, the claims were broadly based and invited review of the entirety of the accounts. "The claims were not limited to any specific products that Respondents purchased. Moreover, in their Revised prayer for **Damages** and Damage Calculation, Respondents asked for $92,808 in commissions and fees, precisely the amount awarded by the arbitration panel." Nevertheless, there was a basis for Petitioners' challenge, so an award of attorney fees for a "frivolous" petition is not warranted. *(ed: The underlying Award is designated* ***NASD*** *ID# 02-02288 (San Diego, 4/30/03). Claimants were represented in the arbitration by Arthur* ***S.*** *Lieder of* ***Investors*** *Arbitration Specialists, Inc. Raymond R. Prazen represented the Claimants in the post-Award proceedings.)* (SLC Ref. No. 2003-38-02)

Financial Network Investment Corporation v. Thielbar, 02 **C 61** 17 (E.D. Ill., 8/26/03). **SRO Rules (NASD Rules 10101 & 10301 "Customer") * Arbitrability * Selling Away * Contractual Issues (Agency-Principal) * Scope of Agreement.** *An agent or representative of a financial service firm is an "associated* ***person"*** ***under*** ***NASD*** *Rule 10301(a) such that a relationship with the agent entitles* ***the*** *investor to the arbitration process.*

Plaintiff, Financial Network Investment Corporation **("FNIC")**, a California corporation engaged in business as a broker-dealer in securities, **was** served with a Statement of Claim filed by Defendants Wayne L. Thielbar, Judith K. Thielbar, Jean L. Williams and Howard W. Hansen (collectively referred to hereinafter as "Defendants"), alleging, *inter alia*, that FNIC, through its licensed agent, John R. Comer ("Comer"), fraudulently sold unregistered securities to them and was responsible for these sales under various doctrines including control person liability, respondeat superior, licensing, agency, negligence per se and negligent supervision. FNIC filed suit, seeking injunctive and declaratory relief, arguing that Defendants were not "customers" of FNIC. FNIC also argued that the transactions at issue did not involve "securities" and that it is only required to arbitrate disputes arising out of, or in connection **with,** its securities business. Defendants then filed a motion to compel arbitration. In granting Defendants' Motion to Compel, the Court concludes that Defendants were customers of Comer, an

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agent or representative of FNIC, and that Defendants' claims must be submitted to arbitration pursuant to **NASD** Rule 10301(a). The Court explains that a customer or investor does not necessarily have to demonstrate that it dealt directly with the **NASD** member in order to demand arbitration. Moreover, **a** claim asserted against **a** brokerage firm for failure to supervise its representatives arises in connection with the brokerage firms' business and falls within the scope of **NASD** Rule 10101. Finally, Plaintiffs did not point to any provision in the **NASD** Code that requires it only to arbitrate claims raised by customers who have purchased "securities," as opposed to other financial products, from **its** registered agent, noting that a claim **is** arbitrable in the absence of a requirement in the Code or case law that the dispute must involve a security. *(P. Michaels)* (SLC Ref. No. 2003-36-01)

Futterman v. Morgan Stanley, B163094, 2003 WL 21931130, 2003 Cal. App. Unpub. LEXIS 7728 (Cal. App., 2 Dist., 8/13/03). **Arbitration Agreement (Form U-4; Uniform Submission Agreement) * Employment Contract * Compensation Issues * Defamation * Stay of Arbitration/ Litigation * SRO Rules (Rule 10305).** *Arbitrators are not free to dismiss a matter from arbitration and refer it to court, where a valid agreement to arbitrate exists.*

On the surface, this decision sounds like many in which registered representatives are compelled to arbitrate because of the clause in Form U-4 and/ or their employment agreement. In the end, the Court finds that those agreements are determinative, i.e., Futterman must arbitrate all his employment-related claims. What makes this case distinctive is its apparent nullification of **NASD** Rule 10305. Futterman first filed his case in court. On MSDW's demand, he agreed to arbitrate and voluntarily dismissed his court action. **As** the hearing date approached, however, he filed a new court complaint asserting state statutory labor **and** wage claims that were not before the panel. He bombarded the panel with motions to stay or dismiss the arbitration **in** favor **of** a court proceeding, including a "Request for Dismissal for Lack of Appropriateness," asserting that he had not agreed to arbitrate his statutory claims. His motion specifically noted (mirroring Rule 10305): **"A party** may request that the arbitrators dismiss the arbitration and refer the parties to their remedies at law." The panel agreed with this request and rendered an award dismissing the matter without prejudice. **[NASD** ID #00-029 11, 2002 WL 31233121 (Los Angeles, 8/22/02).] Undeterred, **MSDW** moved **to** compel arbitration of the second court action. The trial court refused, but the Court of Appeal agreed that Futterman **had** contractually obligated himself to arbitrate all his claims. The Court also attached significance to his Uniform Submission Agreement, a <u>post-dispute</u> commitment to arbitrate that neutralized many potential unconscionability arguments. The majority made no mention of Rule 10305, and Judge **Mosk** (concurring) suggested that the arbitrators' decision may have been "in violation of plaintiff's duty to arbitrate." However, if the award means arbitration before the **NASD** cannot be compelled, the trial court should consider alternatives, including arbitration before the **NYSE** or an **ad** hoc party-selected panel. *(T. Mason: This opinion implies, without analysis, that **Rule** 10305 is meaningless in the face of parties' contractual obligations to arbitrate. MSDW argued that an arbitration panel cannot confer jurisdiction on the state court when the claimant has contractually agreed to arbitrate all disputes. Futterman appeared pro se, possibly contributing to **the** court's failure to **examine NASD** arbitration rules. **The** three judges in this case also decided <u>McManus v. CIBC World Markets Corp.</u>, 109 Cal.App.4th 76, **134** Cal.Rptr.2d 446 (Cal.App. 2 Dist. May 23, 2003) (arbitration* **clause** *imposing a risk that an employee might have to pay arbitration **forum** costs was unconscionable and unenforceable), Citing <u>McManus</u>, **they** implied that Futterman may not **have** to pay forum costs. IMPURTANTNOTE: This decision is **unpublished and** therefore "shall not be **cited** or relied on by a court **or** a party in any **other** action or proceeding." Cal. **Rules** of Court, Rule 977(a) (emphasis added).)* **(SLC** Ref. No. 2003-33-03)

Hakala v. Deutsche Bank, Dkt. No. 02-7501 (2nd Cir., 9/5/03). **Award Challenge * Tmeliness Issues (Statute of Limitations) * State Statutes Interpreted (NY CPLR §§205 & 7511).** *Section 205(a) **of** the NY **Civil** Practice Law & Rules, where applicable, allows six months in which **to file** a motion to vacate, despite the 90-day limitation of Section 7511(a).*

The District Court dismissed Hakala's re-filed petition to vacate an arbitration Award, as Hakala failed to file within 90 days of delivery of the **NASD** Award against him *(sub. nom., Hakala v. **BT** Securities,* **NASD** ID #97-04036 (New York, 11/22/99)). NY CPLR ¶7511(a) so provides, yet Hakala contends that NY CPLR §205(a) allowed six months in his case. He had previously filed a motion to vacate that was timely under §7511(a), but it was dismissed on a "curable procedural irregularity" **(SLA** 2000-35). In such cases, generally, §205(a) provides for re-filing "within six months after the termination." The Court holds that "[t]here is nothing in the wording of §7511(a) to indicate" that §205(a) should not apply to and effectively extend $7511(a). Therefore, **the** Court rules that the complaint should not have been dismissed and the judgment dismissing the action is vacated and the case remanded. *(P. Hoblin: Hakala's* action *was against **his** broker/dealer employer and the court action charged "manifest disregard of **the** law." It will be interesting to **see** how, **four** years hence, the reviewing court **will** act on that charge.)* (SLC Ref. No. 2003-37-01)

Hale v. ProEquities, No. 1011015 (Ala. **Sup. Ct.,** 7/11/03). **Enforceability (Waiver of Arbitration) * Prejudice * Appealability * Discovery Issues.** *Participation in court proceeding **for** two years, especially where*

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depositions are taken, will bar defendant from seeking to compel arbitration one month before trial.

ProEquities' customers claimed conversion in a court action against the broker-dealer and its broker, due to the broker's convincing them to put a substantial portion of their life savings into a single stock and a viatical settlement contract. Defendants filed motions to dismiss or to transfer venue. Following transfer of venue, depositions and other discovery were noticed by both sides. The case was later stayed pending appeal of the broker's criminal conviction. Following the deposition of Mr. Hale, ProEquities first moved to compel arbitration, alleging that it only learned at his deposition that the claims "related directly to" plaintiffs' ProEquities account. Plaintiffs opposed on the basis that defendant had not pled arbitration as an affirmative defense to the original complaint and had delayed for two years following initiation of the court action; they also claimed prejudice due to incurring costs of litigation and delay. The Court applies an abuse of discretion standard in reviewing the lower court's order compelling the parties to arbitrate, because that ruling was based solely on documentary evidence and supporting briefs. While a motion to dismiss or to change venue may not suffice to invoke the judicial process, defendant's participation and failure to object to the trial setting for two years, noticing plaintiff's deposition, and delaying two months after the deposition before first moving to compel arbitration, provides Sufficient evidence of "an intention to abandon the right [to compel arbitration] in favor of the judicial process." In two concurring decisions and one dissenting, the judges all recite the same controlling authority and facts, but reach different conclusions. The dissent cites the heavy burden on a party opposing arbitration and plaintiffs' insufficient proof of prejudice. The dissent also notes that plaintiffs did not show that defendants had obtained through litigation "information not available .through arbitration." (*S. Anderson*) (SLC Ref. No. 2003-35-05)

Hardy v. Walsh Manning Securities LLC,, 2003 U.S. App. LEXIS 16922 (2d Cir., **8/19/03). Award Challenge * Manifest Disregard of Law * Derivative Liability (Respondeat Superior) * Rationale .of Award * Clarification of Award * Rational Basis ("Lack of Colorable Justification").** *When a panel issues a written decision and there is no rational explanation for the basis of the decision, then the award can **be** vacated on **grounds** of **manifest disregard** of the law.*

Claimant Warren Hardy filed a Statement of Claim against Walsh Manning; Frank Skelly, identified as Walsh Manning's "chief executive officer," and Barry Cassese, his account executive, charging all three respondents with misrepresentation and failure to disclose that the securities that Cassese recommended were "house stocks." Before the hearing, Cassese settled with Hardy and agreed to testify against the other two respondents. Walsh Manning and Skelly then asked the panel to specify **the** basis of any award that might be rendered against them because they had filed their own arbitration claim against Cassese. The arbitrators issued an award in which they found Walsh Manning and Skelly to be "jointly and severally liable for ... damages in the amount of $2,217,241 based upon the principles of sespondeat superior." Walsh Manning and Skelly moved to vacate the Award. Skelly argued that he could not be found liable on principles **of** respondeat superior because he was not Cassese's employer, but rather **a** fellow employee. Hence, the award should be vacated because it **was** in manifest disregard of the law. The district court denied the motion to vacate, terming the reference to respondeat superior as "a stray and unnecessary remark," and held that the phrase "based upon 'respondeat superior' referred not to the finding of liability of each respondent, but to the conclusion that both respondents are 'jointly and severally liable."' The Second Circuit acknowledges that it is obliged ***to*** give an arbitral award "the most liberal reading possible'' to save it from vacatur on grounds of manifest disregard. But in this case, the most liberal reading of the award "cannot expunge its statement that Skelly was found liable under principles of respondeat superior. It may very well be that the district court was correct when it characterized the statement as 'a stray and unnecessary remark' but only the Panel can tell us this. ...**It** is **at** least possible that the statement at issue is not 'a stray and unnecessary remark' but is instead an intentional statement made in response to **a** request by Skelly and Walsh Manning that the grounds of their liability be specified." The Court remands the case to the Panel and asks it to: 1) confirm that Skelly is liable only under respondeat superior based on facts not brought to the appellate court's attention which might support such a holding; ***2)*** in the alternative, assert that some other ground of secondary liabil-

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ity applies to Skelly; or **3)** failing both of these, acknowledge that it erred in finding Skelly secondarily liable and that the record does or does not support a finding that Skelly is primarily liable to Hardy. *(P. Dubow) (EIC: The Award can be viewed online: NASD ID #98-04520, New York, 2/13/02. Arbitrators characteristically botch these opportunities to clarify from a probing court, usually because the Panel becomes cryptic and suspicious, when it should be candid and cooperative.)* **(SLC** Ref. No. 2003-35-01)

Kyocera Corp. v. Prudential-Bache Trade Services, Inc., 2003 DJDAR 10077 (9th Cir., 8/29/03). **Appealability * Re-Litigation Issues ("Law of the Case") * FAA (§§10 & 11) * Constitutional Issues (Article III) * Arbitration Agreement * Standard of Review (Judicial) * Enforceability.** *An Appellate Court sitting* en banc *is not bound by the "law of the case" doctrine. The FAA does not permit heightened judicial review of Awards, simply because the parties contracted for it.*

The contract underlying this litigation was formed almost twenty years ago and the dispute that triggered this long-standing controversy first arose in 1986. The arbitration proceeding that visited a $243 million award upon Kyocera and in favor of Prudential-Bache and LaPine Technology Corp. itself lasted from 1987 to 1994. The real frustration and wasted time and expense, though, has to be the last six years, during which the district court, acting upon the direction of the Ninth Circuit, conducted a heightened judicial review of the **1994** Award. That effort has been nullified by this latest ruling in the case. **A** three-judge Panel of the Ninth Circuit determined in 1997 that the parties' agreement, calling for a more pervasive review of arbitral findings of fact and conclusions of law, should be enforced and it reversed the district court's confirmation of the Award under the statutory standards set forth in Section 10 of the Federal Arbitration Act. The current appeal by Kyocera flows from the district court's determination, following the required heightened judicial review, that the Award was legally sound. The three-judge Appellate Panel in this second round *(LaPine II)* followed the same course and confirmed the Award, Kyocera sought and was granted rehearing *en banc*, **a** step it did not take in the first appeal (*LaPine I*). Meeting *en banc* to consider the soundness of the heightened review performed by the district court and the appellate Panel, the Court reaches back in the case's history and overrules the *LaPine I* holding. Instead of engaging in a full review, per the **parties'** agreement, it rejects the predicate and concludes that "private parties have no power to determine the rules by which federal courts proceed, especially when Congress has explicitly prescribed those standards" via the FAA. "Private parties' freedom to fashion their own arbitration process has no bearing whatsoever on their inability to amend the statutorily prescribed standards governing federal court review." **A** large segment of the decision is dedicated to the Court's explanation as to how it was entitled to and should review the ***LaPine I*** ruling. Two of the ***en banc*** Panel disagreed and felt the *en banc* review was improvidently granted. "The parties have no interest in reconsidering *LaPine I* and doing *so* has no effect on the outcome of this appeal." Since neither party asked the Court to consider the question, it was not adequately argued, **and** the supplemental briefing came from parties that did not seek reversal of the *LaPine I* principle. Moreover, "...minimal opportunity for current input [from *amici]* has been afforded despite the fact that there have been six years of realworld experience under the *LaPine* I regime." *(ed: SAC thanks to W. Reece Bader, Orrick Herrington & Sutcliffe, LLP, Menlo Park,* **CA,** *fur alerting us to this decision. It may seem curious that no dissents were registered, but the Ninth Circuit does not **involve** all of the Circuit's Judges in its* en banc *reviews. Eleven judges participated in **this** review. **The** Court's position creates a majority view on this issue that **includes the** Seventh, Eighth and **Tenth** Circuits. The Third and Fifth Circuits are now in the minority, according to the Opinion.)* **(SLC** Ref. No. 2003-36-04)

Mamandur v. Power & Prudential Securities, Inc., No. **02-3898** (8th Cir., 8/27/03). **Award Challenge * Confirmation of Award * FAA (§4 "Jury Trial").** *Vacatur petitions need not be granted evidentiary hearings if the arguments **lack** merit **or** a hearing would be legally unnecessary.*

A claim for wrongful margin liquidation was decided in favor of Prudential and Mr. Powers **(NASD** ID # 00-05512, Little Rock, 5/17/02) and confirmed in the court below. The Eighth Circuit gives the matter six lines, adopting the district court's reasoning, and concluding "that the court did not err in not holding an evidentiary hearing.". **(SLC** Ref. No. 2003-35-02)

Ryan Beck & Co v. Faust, No. **03-CV-636,** 2003 U.S. Dist. LEXIS 15164 (**W.D.** Pa., 8/8/03). **Injunctive Relief * FRCP (Rule 56 "Summary Judgment") * Choice of Law (Penna. v. NY) * Liability Issues (Successor-in-Interest; De Facto Merger).** *Under **New** York law, a de facto **merger** analysis requires continuity of ownership.*

Ryan Beck expressly declined to assume claims and arbitrations arising from transactions preceding **an** Asset Purchase Agreement with Gruntal & Company, Inc. Defendants, clients of Gruntal, filed an arbitration against Ryan **Beck** for transactions occurring prior to the Asset Purchase Agreement. The Court granted Ryan Beck's motion for preliminary injunction and enjoined the **NASD** arbitration. In granting Ryan Beck's motion for summary judgment, the Court rejected Defendants' argument that Ryan Beck was the successor-in-interest to Gruntal under either the *de facto* merger **or** fraud exceptions to the general rule of no successor-in-interest liability in the absence **of** an express or implied assumption. **With** respect to the former, although Defendants conceded that there was no continuity of ownership, they argued that, unlike Pennsylvania,

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New York law did not require continuity of ownership as an indispensable element of the *de facto* merger exception. Citing Cargo Partners AG v. Albatrans, Inc., 207 F. Supp.2d 86 (S.D. N.Y. 2002), the Court reasons that, with a possible exception for product liability cases, ownership continuity is an essential element for the traditional *de facto* merger exception under New York law. With respect to the fraud exception, the Court finds that the evidence falls "well short" of that which would support an inference of fraud or create a genuine issue of material fact with regard thereto. *(W.* ***Nelson)*** *(EIC: Joel E. Davidson, Davidson Menchel & Brennan, Northvale, NJ, represents Ryan Beck in* ***this*** *case. In* ***the usual*** *"selling away" cases, the answer to the question,* ***"Is*** *the investor a 'customer' for purposes of* ***NASD*** *Rule 10301(a)?" does not answer the question "Is the broker-dealer liable for the broker's actions?" Query whether the Court's answer on the obligation to arbitrate* ***in*** *this case also answers the liabililty* ***question. This Court*** *only fielded the arbitrability question.)* (SLC Ref. No. 2003-35-04)

Waul v. Charles Schwab & Co., No. A099066, (Cal.App., 1Dist., 7/31/ 03). **Arbitrability * Injunctive Relief * State Statutes Interpreted (Calif. Bus. and Prof. Code, § 17200 "Unfair Competition)') * FAA (Generally) * Remedies (Restitution; Disgorgement)).** *Claims for injunctive relief under the California* ***Business*** *and Professions Code Section 17200 are nut arbitrable.*

The Court of Appeals affirmed the district court's denial of Schwab's motion to compel arbitration of the Section 17200 claim, reasoning that a consumer action to enjoin deceptive practices is undertaken for public, rather than private benefit, and that the judicial forum is uniquely better suited to administer the injunction and protect the public benefit. Since there is an "inherent conflict" between the public policy in favor **of** arbitration and the public policies protected by Section 17200 injunctions, the injunctive claims are not arbitrable. (W. *Nelson) (EIC: The Court did* ***reverse*** *the portion of the trial court's order denying arbitration of Waul's restitution and disgorgement* ***claims.*** *Mr. Waul's claim challenges Schwab's funds availability policy, which purportedly places a 5-business day hold on a customer's check before crediting funds to the account, even though the funds may be received earlier.)* **(SLC** Ref. No. 2003-34-01)

Whitfield & Investment Centers of America, In Re (Rash v. Whitfield & ICA), No. 09-03-246CV (Tex.App., 9Dist., **8/28/03). Appealability * Arbitrators, Authority of * Fraudulent Inducement.** *If the parties admit to the existence of an agreement to arbitrate, the agreement itselfneed not be submitted.*

This is a mandamus proceeding, in which broker Whitfield seeks to compel arbitration of fraud and negligence claims, based upon an arbitration agreement contained in a "Disclosure Agreement." All parties admit the existence of the agreement, but it was never put in evidence. This Court holds that it was sufficient to establish existence of an agreement, which they did through the oral admissions, pleadings and other documents. The Court also holds that the customers' allegations of fraud pertain to the entire contract, not the arbitration clause itself and must, therefore, be decided by the arbitrators, not the courts. The trial court is ordered to abate the proceedings below pending arbitration. *(P. Hoblin: It seems that a lot of time would have been saved if the Disclosure Agreement had been attached to the complaint.)*) (SLC Ref. No. 2003-36-02)

SAC's Bulletin Board

The *Bulletin Board* is open to all subscribers who wish to post a message related to arbitration practice or process, free of charge. When insufficient room is available, you may not see your message until the next issue. Please check with us if you are uncertain about when your announcement will appear..

People

Brown Raysman is pleased to announce that the following attorneys have joined the Firm: **Madelaine F. Baer, Robert M. Bauer, Daniel Hansburg, Lisa Holstein, Benjamin H. Green,** and **C. Evan Stewart.** Mr. Stewart joins as a partner in the firm's Litigation practice group in New York. He has extensive experience both in the financial services industry and in representing clients in complex civil and regulatory litigation. He has handled numerous trials and appeals in federal and state courts, **as** well as having tried a multitude **of** arbitration proceedings before the **NASD, NYSE** and the AAA. Mr. Stewart was previously **EVP** and General Counsel and Secretary of the Nikko Securities Co. Intl., Inc. and served as First VP and Associate General Counsel of E.F. Hutton & Co., Inc. in charge of its Litigation Department. Tel: 212/895-2670. E-Mail: estewart@brownraysman.com.

Sandra D. Grannum has joined Joel E. Davidson, Lisa Catalano **and** David I. Becker in the practice of law. Sandy graduated from Harvard Law School in 1986. She **was** a litigation associate at the New York law **firm** of Cravath Swaine & moore for **six years.** Sandy joined UBS Paine Webber (now UBS Financial Services) in 1997 **and** became a Senior Associate General Counsel in its Employment Law Unit in 2001. Prior to that, Sandy handled a variety of complex sales practice litigations and arbitrations for UBS PaineWebber. The new **firm** will be know **as Davidson & Grannum, LLP** (formerly the New **York** and New Jersey offices of Davidson, Menchel & Brennan). The **firm,** which has offices in New York and New Jersey, represents broker-dealers in securities arbitrations and litigations **and** also focuses on employment law and commercial litigation. Tel: 201/802-9000.

The Lax Law Firm is pleased to announce the opening **of** its offices at 444 Park Avenue South, 11th Flr., New York, NY 10016. **Barry R. Lax** has an extensive background in commercial, employment and securities litigation. The Firm will specialize in the same, including **NASD, NYSE** and **AAA** Arbitrations, representing investors, employees and employers in employment disputes, and brokers and broker-dealers in customer arbitrations, class actions, and enforcement and regulatory proceedings. Address: 444 Park Ave. So., NYC, 11th Flr. (10016). Tel: 212/696-1999. Fax: 212/696-1231. WebSite: www.laxlawfirm.com.

The Martens Law Firm, Tequesta, Florida, is pleased to announce that **Jessica M. Vasquez, Esq.** has joined the Firm as an Associate. Ms. Vasquez may be reached by telephone at 561/746-3699, by e-mail at jmvf@bellsouth.net or you can visit the Firm WebSite at www.martensatty.com.

John G. Rich and **Ross B. Intelisano** announce the formation of **Rich Intelisano LLP, a** New **York** law firm practicing in the areas of securities and commodities arbitration and litigation, securities industry employment arbitration and regulatory matters, commercial arvitration and litigation, and employment and partnership law. Rich Intelisano LLP will primarily represent investors in securities and commodities fraud arbitrations and employees in disputes with broker-dealers. Messrs. Rich and Intelisano previously worked together at Eppenstein & Eppenstein, where they tried large and complex securities **and** commodities fraud cases. They worked extensively on **the** Blumenfeld v. Refco commodities arbitration at NFA, which resulted in a $42 million award, at the time, the largest collectible award ever rendered on behalf of retail customers in arbitration. Prior to Eppenstein, Mr. Rich practiced securities and commercial arbitration and litigation at Davis Polk & Wardwell. Mr. Intelisano recently left Bauman katz & Grill, where he ran the firm's securities arbitration and employment practice. Address: 1 Trinity Centre, 111 Broadway, Suite 1303, New York, **NY** 10006. Tel; 212/433-1480. Fax: 212/433-1481. E-Mail: jrich@richintelisano.com; rintelisano@richintelisano.com.

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Announcements

In August, **SLC** (Securities Litigation Commentator/Alert) Contributing Editor **and Boston lawyer Fete S. Michaels of Murphy & Michaels,** was honored by the American **Bar** Association as an "Outstanding Editor" for the 2002-2003 year for his work on ***Securities New,*** an **ABA** publication of high repute. We congratulate Pete for his fine work as an author and commentator on important legal issues in the securities arena.

SCHEDULE OF COMING EVENTS

If you know of an arbitration event scheduled in the coming quarter, please tell us and we'll post it here.

Oct. 23-26: PIABA Annual Meeting and Conference, will be held at the La Quinta Resort and Club, LaQuinta, CA. For info., visit www.piaba.org or contact the PIABA office at 1.888.621.7484 for personal assistance.

Oct. 29-31: "NSCP 2003 National Membership Meeting," sponsored by the National Society of Compliance Professionals, will be held at the Crystal Gateway Marriott Hotel, **Arlington, VA.** Keynote Speaker: Mary L. Schapiro, **NASDR.** "42 subjects in 3 days starting at just $550." For info., contact NSCP, 22 Kent Road, Cornwall Bridge, CT 06754.

Oct. 30: "Effective Mediation Advocacay: Tips for Representing the Client," hosted by the New York County Lawyers' Association, will be held at NYCLA's Vesey St. Assembly Room in **New York, NY. A** faculty of mediators and litigators will present talks on mediation preparation, participation and ethics. Regis. Fee: $105/ $140. For info., contact the CLE Institute at 212/267-6646, x216.

Nov. 4: "Fall Compliance Seminar,Ó sponsored by the SIA Compliance & Legal Division, will **be** held at the Roosevelt Hotel, **New York, NY.** The listed topics are Current Enforcement Issues, Research, International Compliance, Surveillance & Technology, Hedge Fund Due Diligence, The Examination Process, Anti-Money Laundering, Equity Trading, Fixed Income, Corporate Governance & Ethics (choose three). Regis. Fees: $275/ 325. For info., contact Daniel Goldstein & Assocs., 518/785-0721.

Nov. 6-8: "35th Annual Institute on Securities Regulation," sponsored by the Practising Law Institute, will be held at the New York Hilton Hotel, **New York, NY.** The Program "promises **to** provide practical solutions to the challenges confronting you and your clients. The chairs, David B. Harms of Sullivan & Cromwell LLP, Curtis L. Mo of Weil, Gotschal & Manges LLP and Linda C. Quinn **of** Sherman & Sterling LLP, have gathered an expert faculty who will guide you through the latest issues facing securities and corporate law practitioners." Regis. Fee: $1,795. For info., contact PLI, 800/ 260-4PLI.

Dec. 11-12: "Understanding Securities Laws," sponsored by the Practising Law Institute, will be held at PLI's New York Center in **New York, NY.** Program Chairs Jeffrey **S. Hoffman.** Swidler Berlin, and N. Adele Hogan. Cravath Swaine & Moore, will lead a faculty of **SEC** staff, experienced securities lawyers, and a law professor through a tour of the federal securities laws, how they affect corporate clients, and how a securities lawyer can solve practical problems. Regis. Fee: $1,295. For info., contact **PLI,** 800/260-4PLI.

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TO: Richard P. Ryder, Editor
Securities Arbitration Commentator
P. **O. Box** 112
Maplewood, **N.J.** 07040.